HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15918

RECEIVED
OCT 16 2015
OFFICE OF THE SECRETARY

In the Matter of the Application of:

DENNIS J. MALOUF

Respondent.

RESPONDENT'S REPLY IN FURTHER SUPPORT OF PETITION FOR REVIEW AND RESPONSE TO DIVISION'S BRIEF IN SUPPORT OF CROSS-PETITION FOR REVIEW

TABLE OF CONTENTS

TABLE OF AUTHORITIES

I. INTRODUCTION

The Division's case against Mr. Malouf is based entirely on the fact that he was the CEO of UASNM – "top dog" as the Division calls him -- during the time period at issue. Given his role as CEO, the Division argues that he is, in essence, strictly liable for any and all compliance failures at the Firm during his tenure.

The defect in the Division's theory is that identifying Mr. Malouf as the CEO is only the *first* step in the pertinent analysis. Mr. Malouf only possesses the "ultimate responsibility" over the Firm *unless and until* he properly delegates that responsibility to a qualified individual. That is what happened here. Mr. Malouf delegated the Firm's compliance obligations to its CCO – Mr. Joseph Kopczynski – a qualified and well experienced compliance officer. This delegation passed the "ultimate responsibility" for compliance from Mr. Malouf onto Mr. Kopczynski. If failures ensued, it is Mr. Kopczynski who should have been called upon to answer for them. That call never came.

Instead, while ignoring (but not contesting) the delegation of authority to Mr. Kopczynski, the Division placed sole, *de facto* responsibility on Mr. Malouf for any mistake made by the Firm. Most alarming, the Division pursued Mr. Malouf while vehemently defending Mr. Kopczynski, who, it appears, either intentionally failed to fulfil his compliance obligations or was so blind to the sea of red flags waving before him that he recklessly failed to do so.

Nevertheless, in its Response,[1] the Division seeks to increase the sanctions imposed on Mr. Malouf, asking that, in addition to the disgorgement of "excessive" commissions it has already received, that it also be awarded disgorgement of valid, legal installment payments Mr.

[1] Refers to the Division of Enforcement's Brief in Support of its Cross-Petition for Review and Response to the Respondent's Brief in Support of Petition for Review, cited herein as "Div. Br. p. ___."

Malouf received from the sale of his branch office. As if that is not enough, it also seeks to bar him from the industry for life – all for someone else's failure.

For the reasons set forth herein, and in Mr. Malouf's Brief in Support,[2] Mr. Malouf respectfully asks that the Commission properly apply the law in this case, reverse the findings and conclusion in the Initial Decision that Mr. Malouf was responsible for any violative conduct, vacate the award of sanctions, reverse the order of disgorgement, and deny the Division's cross-petition in its entirety.

II. RESPONDENT'S REPLY IN FURTHER SUPPORT OF HIS PETITION FOR REVIEW

A. The Initial Decision failed to apply and follow the applicable law.

It is undisputed in this case that Mr. Malouf delegated the Firm's compliance responsibilities to Mr. Kopczynski, the Firm's CCO. Tr. 1060:24-1062:6; Resp. Exs. 346-350; Tr. 1323:18-22. It is also undisputed that Mr. Kopczynski's responsibilities as CCO included: (a) the Firm's Forms ADV; (b) the contents of the Firm's website, and (c) the Firm's best execution policies.[3] The Firm's compliance manuals and Mr. Kopczynski's testimony confirmed the same. *Id.;* FOF 47, 55, 58 and COL 20; Resp. Ex. 346; Tr. at 1287; 1289:6-25; and 1352-1357; Tr. 1361:5-25. The Division did not even attempt to present evidence that would rebut this clear demonstration of delegation by Mr. Malouf, nor did it bother to make any arguments to the contrary in its Brief.

In the presence of such clear, unrebutted evidence of delegation, the law is clear. The president of a firm "is responsible for the firm's compliance with all applicable requirements ***unless and until*** he or she reasonably delegates a particular function to another person in the

---

[2] Respondent's Brief in Support of Petition for Review, filed September 1, 2015, cited herein as "Resp. Br. p.__."

[3] FOF 16, COL 21, Ex. 346-350; Tr. 1287; 1289:6-25; and 1352:16-1357; Tr. 1361:5-25; Tr. 1280:24-1281:10; Tr. 1298:5-1302:9; Tr. 1306:11-18.

firm, and neither knows nor has reason to know that such person is not properly performing his or her duties." *John B. Busacca III*, Exch. Act Rel. No. 63312, 2010 SEC LEXIS 3787, at *37 (Nov. 12, 2010) (internal citations omitted).

Here, the conclusion that Mr. Malouf delegated responsibility for the Firm's compliance functions to Mr. Kopczynski is uncontroverted; indeed, the Division has not challenged this finding. Therefore, because such a delegation in fact occurred – meaning the "unless and until" precondition was satisfied – the ALJ was then required under the applicable law to answer two follow-up questions:

> 1) Whether the delegation was reasonable, i.e., did the person who received the delegated responsibilities (Mr. Kopczynski) possess sufficient knowledge and expertise to handle the delegated duties, and
>
> 2) Did the delegator (Mr. Malouf) ensure that Mr. Kopczynski was performing his duties in a reasonable manner?

In the Matter of Thomas R. Delaney II & Charles W. Yancey, Rel. No. 755 (Mar. 18, 2015). If the answer to both questions was "yes," that is, Mr. Kopczynski did have the requisite knowledge and expertise, and Mr. Malouf did believe Mr. Kopczyski was performing his delegated duties in a reasonable manner, then the ALJ was *required* to conclude that Mr. Kopczynski, not Mr. Malouf, bore "ultimate responsibility" for any compliance failure by the Firm.

The Initial Decision erred, however, in failing to apply the above analysis. Despite correctly finding that Mr. Malouf had clearly delegated his compliance authority to Mr. Kopczynski, the ALJ inexplicably cut off the analysis prematurely, as he failed to answer, or even pose, the two requisite follow-up questions. By not considering anything beyond the "***unless and until***" clause, the ALJ came to the erroneous conclusion that Mr. Malouf, not Mr. Kopczynski, bore ultimate responsibility.

The Judge's failure to apply the law in this case is reversible error. The Commission should undertake the proper analysis, based on the undisputed facts presented in the record, and determine that it is Mr. Kopczynski, not Mr. Malouf, who bore "ultimate responsibility" for any compliance failures made by the Firm. Furthermore, because the Initial Decision wrongly saddled Mr. Malouf with liability, the Commission should reverse the findings made against him, including the ALJ's award of disgorgement, civil penalties, a cease and desist, and a limited bar.

1. Under the applicable authority, Mr. Malouf properly delegated authority to Mr. Kopczynski.

A proper application of the law to the facts established at the hearing mandates the conclusion that (1) Mr. Malouf delegated compliance responsibility to Mr. Kopczynski; (2) Mr. Kopczynski was certainly qualified for that responsibility; and (3) Mr. Malouf reasonably believed Mr. Kopczynski was performing his duties.

As stated above, it is undisputed (and unchallenged) that Mr. Malouf delegated responsibility for the Firm's compliance functions, including those functions regarding the content of Form ADV and the Firm's website, to Mr. Kopczynski. Thus, there is nothing left to discuss about this issue.

It is likewise undisputed that Mr. Kopczynski was qualified to perform these delegated functions. Prior to becoming the CCO of UASNM, Mr. Kopczynski had been the CCO of UAS since its inception in 1990, accumulating well over a decade of experience before he assumed the same role at UASNM. Tr. 1391:7-13. Mr. Malouf believed him to be the most knowledgeable of the Firm's principals when it came to compliance matters. FOF 98, 102; Tr. 1018:3-16; Tr. 1062:19-1063:6. It is further evident, and uncontested by the Division, that Mr. Kopczynski, by all appearances, was performing his compliance duties in a reasonable manner (even utilizing a compliance expert, ACA, to assist him), and that Mr. Malouf relied on his experience and knowledge base. Tr. 994:10-25; Tr. 1062:25-1063:6.

Given these uncontradicted facts, the above analysis leads to the inescapable conclusion that it was Mr. Kopczynski, and not Mr. Malouf, who bore "ultimate responsibility" for the Firm's compliance functions – specifically including Forms ADV, the content of the website, and its best execution practices. Therefore, to the extent the Firm was deficient in some manner with regard to those functions, it *has to be* Mr. Kopczynski, not Mr. Malouf, who is properly deemed liable for those deficiencies.

To ignore the undisputed facts and the pertinent law and hold Mr. Malouf responsible, simply because he was the CEO at the time, is an abhorrence of justice, and must be reversed.

2. Contrary to the Division's theory of the case, "delegating authority" is not equivalent to "blame-shifting."

The Division fails even to acknowledge the existence of these facts or the applicable law in its Response, however, choosing instead simply to deride Mr. Malouf. Indeed, what the law calls "delegation," the Division pejoratively labels "blame-shifting."[4] It continues to construe Mr. Malouf's entirely normal and wholly proper conduct as something nefarious, as though by delegating the responsibility for *compliance* to the Firm's *compliance officer* and then expecting that the officer actually *perform compliance functions*, Mr. Malouf somehow acted not just unreasonably, but unlawfully.[5] Indeed, in its transparent attempt to downplay the importance of

[4] Such a defense would hardly be surprising, were it coming from Mr. Kopczynski in an attempt to shield himself from personal liability on the Division's claims. But Mr. Kopczynski is *not* facing any liability, and the defense is *not* coming from him – it is coming from the Division. That is, the Division argues, despite a clear delegation of authority, that the Firm's Chief Compliance Officer should somehow not be held accountable for his ongoing failures to uphold and apply the Firm's policies and practices and ensure that they were being followed.

[5] The Division cites, many times, Mr. Malouf's acknowledgment that he was the "top dog" at the Firm or that "the buck stopped with him" as evidence that he should be held responsible for the compliance issues at hand. Its position that these passing comments, instead of the law, should govern in this case is unsupported and unpersuasive. E.g., Div. Br. p. 20. Like the ALJ, the Division fails to look past Mr. Malouf's role as "top dog" to

Mr. Kopczynski's vital compliance role at the Firm, the Division refers to him as Mr. Malouf's "employee[]," as though he was some low-level assistant, rather than a corporate officer operating at the highest echelon of management.[6]

Nevertheless, the Division's "blame-shifting" vernacular is a classic red herring, designed to distract from the fatal flaw in its case, namely, that for some reason, it prosecuted the wrong individual – Mr. Malouf – in an effort to hold him responsible for the compliance lapses of another individual – Mr. Kopczynski – whom the Division has inexplicably embraced. Asking the Commission to cure that flaw is not "blame-shifting"; it is justice.

3. The Division confuses the origin of the conflict with the duty to disclose it.

In the Division's own recitation of its case, it sums its position up as follows: Mr. Malouf had a conflict and admitted it, the conflict was not disclosed, therefore, Mr. Malouf is liable. Div. Br. p. 18. The Division's theory, however, misses an important distinction. There is no dispute that the conflict at issue here was created by Mr. Malouf's relationship with RJFS. There is also no dispute, however, that it was the responsibility of the CCO, Mr. Kopczynski, to make sure that the Firm made that disclosure on its Form ADV. Tr. 1323:18-1326:11. Specifically, the Firm's compliance manuals provided:

> The CCO [Kopczynski] is responsible for ensuring the Parts 1A and Part II of UASNM's Form ADV are properly maintained and disseminated. Accordingly, the CCO will periodically review the ADV to ensure that it is accurate and complete.

---

inquire whether he appropriately delegated his compliance responsibilities to others. Under the Division's rather facile analysis, *every* CEO is necessarily liable for all compliance failures, regardless of efforts to delegate compliance duties, because *every* CEO is by definition "top dog" at his or her firm.

[6] Div. Br. p. 18.

E.g., Resp. Ex. 346, p. 51. Thus, *regardless* of which investment adviser at UASNM had a conflict that needed to be disclosed on the Firm's Form ADV, it was Mr. Kopczynski's responsibility to make sure that the disclosure was made.

The most shocking part of this case has been Mr. Kopczynski's success in avoiding any accountability for his failure to disclose by meekly arguing that he never knew all the "specifics" regarding the sale transaction, and that he never saw the agreement. Mr. Kopczynski maintains this argument despite the fact that:

- He was aware that Mr. Malouf sold the RJFS branch office to Mr. LaMonde. FOF 34, 50.
- He was aware or at least suspected that Mr. Malouf had sold the RJFS branch to Mr. LaMonde pursuant to an installment agreement.[7] *Id.;* FOF 50, 51.
- He knew that Mr. LaMonde had not yet paid in full and was making ongoing payments to Mr. Malouf. FOF 53, 59.
- Mr. Malouf testified that he specifically told Mr. Kopczynski that Mr. LaMonde had agreed to pay him for the branch over a period of time. Tr. 1130:6-15.
- He knew the Firm continued to clear certain trades through Mr. Malouf's former RJFS branch, during the same time that Mr. Malouf was receiving payments from Mr. LaMonde. FOF 159.

Respectfully, what other specifics regarding the sale are pertinent for the CCO to be aware of? The consideration of potential conflicts of interests starts with the money: who are you receiving money from and for what purpose? Mr. Kopczynski had this information or at least "suspected" his information to be accurate. Regardless of the other provisions contained in the terms and conditions of the installment contract, Mr. Kopczynski knew the "specifics" that were relevant to disclosure. He intentionally, or, perhaps, recklessly, failed to fulfill his

[7] Mr. Kopczynski suspected Mr. Malouf's sale of his branch followed a similar format to the one Mr. Malouf had utilized years earlier (in purchasing UAS from Mr. Kopczynski himself).

obligations by not investigating the "red flags" before him, and then making the appropriate disclosure. Amazingly, the Division is rewarding Mr. Kopczynski for these lapses.

Accordingly, regardless which adviser at the Firm the conflict arose from, the failure to disclose that conflict was Mr. Kopczynski's, and his alone. He, and not Mr. Malouf, is accountable for any failure to honor that obligation.

B. <u>The Division wrongfully advocates an "ostrich pose" defense for compliance officers.</u>

Equally troubling is the Division's apparent contentment to allow the Firm's management (excluding Mr. Malouf, of course) to shirk their respective compliance obligations by intentionally ignoring – and refusing to investigate – the "specifics" of conduct occurring within their Firm. By allowing them carefully to limit their "knowledge" of certain conduct that took place at their branch, Mr. Kopczynski and Mr. Hudson will become, perhaps, the first of many compliance officers allowed to avoid liability by simply and deliberately closing their eyes to what was happening around them.

The facts regarding the sale of the branch are straightforward. From the time of UASNM's inception in 2004 onward, Branch 4GE operated out of the same office space as UASNM, that is, the same office space controlled and managed by Mr. Kopczynski, Mr. Hudson and Mr. Malouf. FOF 2, 3, 15, 16, 325. In 2007, Mr. Malouf terminated his association with RJFS and sold Branch 4GE (the "Branch") to Mr. LaMonde. FOF 5, 19. Both Mr. Hudson and Mr. Kopczynski were aware that Mr. Malouf had sold the Branch to Mr. LaMonde. FOF 34. Pursuant to the purchase agreement between Mr. Malouf and Mr. LaMonde, Mr. LaMonde was required to make certain regular payments to Mr. Malouf until he satisfied the purchase price of the Branch. FOF 293, 294. Mr. LaMonde made the payments. *Id.* The payments from LaMonde to Mr. Malouf were not a secret. FOF 347. UASNM's bookkeeper was aware of them because she received and deposited – at least twice each month – Mr. LaMonde's checks to Mr. Malouf. Mr. Hudson, the Firm's CEO, knew about them as early as 2008.

What the Division calls Mr. Malouf's secret "scheme" was actually an open, obvious, and well-known fact within the office. Mr. Kopczynski knew about the sale and knew (or surely should have known) about the payments (and the potential conflict created thereby). The Division's vehement attempt to defend Mr. Kopczynski by arguing that he lacked "specifics" of the deal ignores the reality of the instant situation. Perhaps worse, it has absolved Mr. Kopczynski, the CCO, from any compliance obligations triggered by his possession of that knowledge. Surely, the ability to avoid regulatory scrutiny merely by deliberately limiting one's knowledge of a fact that should reasonably be explored further – a classic "red flag," if there ever was one – is defense that has been attempted without success by countless respondents and defendants. To see it so fiercely advocated here by the Division on Mr. Kopczynski's behalf is odd, indeed.

C. <u>Best Execution</u>

The Division further failed to carry its burden and establish, by preponderance of the evidence, that Mr. Malouf failed to seek best execution as alleged in the OIP.[8] In some instances, it failed to present any evidence *at all*. Yet, it was allowed recovery on its claims.

The Division attempts to overcome this evidentiary deficit by identifying a small handful of trades – specifically, four – that it claims were proven to be Mr. Malouf's. Div. Br. p. 25. Yet, the OIP did not allege that Mr. Malouf failed to seek best execution on four trades. Rather, it alleged failure "on the *vast majority* of these trades." Order Instituting Proceedings, Ex. 313, p. 2. Failure to prove this allegation should have been fatal to the Division's claims, as a matter of law. *Steadman v. S.E.C.* 450 U.S. 91 (1981). What is exceptional in this case is that the ALJ

[8] Order Instituting Proceedings, Ex. 313, p. 2.

held Mr. Malouf liable despite expressly recognizing the Division's (apparently) intentional decision not to prosecute its case fully:

> To prove [that Mr. Malouf was responsible for more than 60% of the trades], the Division *could have inquired* of witnesses as to each trade, using all the documentary evidence available. However, *such evidence was not presented by the Division.*

Initial Decision p. 36.

At best, the Division was able to assemble the following "evidence" that supported its claims:

- Four emails reflecting four trades by Mr. Malouf. (Div. Br. p. 25);
- Mr. Malouf stipulated that he assisted Mr. Keller with one specific bond transaction. (Div. Br. p. 25);
- Mr. Hudson testified that Mr. Malouf was UASMN's "bond expert." (Div. Br. p. 25);
- Mr. Hudson testified Mr. Malouf placed "large" bond trades. (Div. Br. p. 25);
- The Division's expert found that the trades he chose to review averaged $1,000,000 per trade. (Div. Br. p. 25);[9]

What the Division fails to understand (or declines to acknowledge) is that it did not merely fail to prove the *volume* of Mr. Malouf's trades, it failed to present evidence that those trades executed by Mr. Malouf carried commissions that were demonstrably "excessive." Instead of introducing this evidence, the Division sought to prove it by extrapolation. That is, it elicited testimony as to Mr. Malouf's estimated total trade volume, conjured up an "acceptable commission range" (unsupported by any articulated standard or authority), and then argued that Mr. Malouf was responsible for trades that fell outside of this "applicable range." Missing from this analysis is

[9] The Division also notes Mr. Malouf's stipulation that "various witnesses have estimated that Malouf placed between 60% and 95% of the trades." (Div. Br. p. 25). The Division's excitement over this stipulation is perplexing, given its wording. First, it merely stipulates to the existence of testimony by others. Second, and more important, it stipulates that "various witnesses" ***estimated*** Mr. Malouf's bond trades. That is, other people testified they ***thought*** his trade percentage fell somewhere across a 35% spectrum. In citing this authority, the Division gives itself a healthy margin of error.

evidence that Mr. Malouf was, in fact, responsible for the *particular trades* that charged a purportedly excessive commission. Also missing is evidence that the commissions charged on Mr. Malouf's trades were, in fact, excessive at all.

As is the case with its disclosure claims, the Division is confident that some misconduct must have occurred – it simply failed to take sufficient efforts to identify the individual actually responsible for it.

Furthermore, the Division's claims presuppose an obligation by Mr. Malouf to solicit multiple bids on each and every bond trade in order to determine if the price quoted was reasonable. Yet, the experts called to testify in this case agreed that no such obligation exists. Instead, "best execution" requires "execut[ing] securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances." *Interpretive Release Concerning the Scope of Section 28(e) of the Securities and Exchange Act of 1934,* Exch. Act. Rel. No. 23,170 (Apr. 23. 1986). Whether the client's transaction is processed in the "most favorable circumstance" requires an analysis of "the full range and quality of a broker's services...including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility and responsiveness...." *Id.* Best execution "is not [determined by] the lowest possible commission cost." *Id.*

The Division ignores this "full range and quality" analysis and focuses on a single factor: cost. In addition to running afoul of the applicable standard (to which Mr. Malouf should be held), it also ignores the fact that Mr. Malouf took many steps to ensure that his customers obtained a "full range and quality" of services.

In its Response, the Division brushes off Mr. Malouf's relationship with RJFS[10] in a single sentence, arguing that it holds a lesser duty to its customers (UASNM's customers) and therefore it cannot be depended on. Div. Br. p. 31. Yet, merely comparing the duties owed by a broker-dealer and the duties owed by an investment adviser misses the point. The importance of RJFS's involvement in the transactions (including Mr. Malouf's long history working with the firm and his election to utilize its BondDesk service[11]) is that it demonstrates the practices and procedures Mr. Malouf implemented to survey the broader market and ensure he was achieving the most competitive prices. Moreover, this evidence showed that Mr. Malouf was continuously cognizant of the importance of providing a "full range and quality of services to his clients," including research (he believed RJFS's research to be "spot on"),[12] execution quality (RJFS was able to handle large transactions, quickly),[13] and did so at a reasonable cost.[14]

This evidence showing Mr. Malouf's efforts to ensure "best execution" for UASNM customers (as the term is defined by the Interpretive Release") stands in stark contrast to the incredible lack of evidence presented by the Division. Accordingly, for the reasons set forth herein and in Respondent's Brief in Support, the ALJ's finding that Mr. Malouf failed to seek best execution, and all sanctions imposed as a result of that finding, should be reversed and the Divisions' best execution claims denied.

---

[10] Raymond James Financial Services, which supervised the branch through which the transactions at issue were placed.

[11] A full discussion of the salient facts and points is presented in Section C of Respondent's Brief in Support.

[12] Tr. 1091:12-1092:19.

[13] Tr. 1092:20-1094:2; Tr. 1095:21-22; Tr. 1106:24-1107:8.

[14] *Id.*

III. RESPONSE TO THE DIVISION'S BRIEF IN SUPPORT OF CROSS-PETITION FOR REVIEW

A. Because the finding of liability against Mr. Malouf for the Firm's compliance failures was improper, no sanction is warranted.

As discussed above and in Respondent's Brief in Support, because Mr. Malouf properly delegated the Firm's compliance obligations to Mr. Kopczynski, and reasonably believed that Mr. Kopczynski was performing his duties as CCO to the best of his ability, Mr. Malouf should not be held liable for those properly delegated functions. Because liability is not warranted, neither are sanctions, including the increased sanctions described in the Division's Brief.

As a result, the sanctions imposed in the Initial Decision should be reversed and the Division's request for increased sanctions, advocated in its Cross-Petition for Review, should be denied.

B. The Division has failed to establish that sanctions (including a bar) are warranted.

The Division argues that the ALJ exceeded the parameters of Section 203(f) by awarding a time-limited bar (opposed to a permanent bar) against Mr. Malouf. Essentially, the Division argues that Section 203(f) only allows temporary bars of up to one year and that anything longer than one year must be permanent. Even if the Division's technical reading of the statute is correct, and Section 203(f) does, in fact, restrict the power of the Commission to award a time-limited bar otherwise found to be appropriate under *Steadman*, the result of that error is not to *increase* the length of the sanction imposed.

Under both Section 203(f) and Section 9(b) of the Investment Company Act, the primary consideration in determining whether to exclude someone from the securities industry is whether exclusion is in the "public interest." Determining the public interest requires an analysis of the factors set forth in *Steadman v. S.E.C.* 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other* *grounds*, 450 U.S. 91 (1981 ("*Steadman* factors"): (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infraction; (3) the degree of scienter involved; (4) the sincerity of the respondent's assurances against future violations; (5) respondent's recognition of the wrongful nature of his or her conduct; and (6) the likelihood that the respondent's occupation will present opportunities for future violations. The Commission's inquiry into the appropriate sanction to protect the public interest is flexible, and no one factor is dispositive. *Gary M. Kornman*, Exch. Act Rel. No. 59403, 2009 SEC LEXIS 367, at *22 (Feb. 13, 2009).

In determining whether to issue an industry-wide bar, like the one the Division requests, "the law judge's analysis should be grounded in specific findings regarding the protective interests to be served by barring the respondent and the risk of ***future misconduct***." *In the Matter of Haider Zafar*, Release No. 862 (Aug. 18, 2015) (emphasis added). The focus of this analysis is on ***future conduct***, not past, as "[c]ourts have held the existence of a past violation, without more, is not a sufficient basis for imposing a bar[,]" *Tzemach David Netzer Korem*, Exch. Act Rel. No. 70044, 2013 SEC LEXIS 2155, at *23 n.50 (July 26, 2013) (emphasis added) (citations omitted).

Thus, regardless of the time parameters associated with a proposed bar, the Division is nonetheless required to prove it is within the public interest and will deter future misconduct. For the reasons set forth in Respondent's Brief in Support, Section E, the Division has failed to prove that the sanctions sought meet those standards. Specifically, the evidence showed that Mr. Malouf's conduct was neither "egregious" nor performed with *scienter*. Instead, Mr. Malouf acted in good faith reliance and with a good faith belief that the Firm was in compliance with the applicable rules and requirements. To ensure compliance, Mr. Malouf appointed an experienced and knowledgeable CCO and hired an experienced compliance consultant to advise the Firm on its disclosures – actions indicative of a person acting in good faith. FOF 97, 99, 139, 303.

Additionally, under the facts of this case, is no likelihood of future violations (immediately after Mr. Malouf learned that the disclosure was absent, he revised the Form ADV to disclose the existence of a potential conflict) nor is there any evidence of outstanding customer harm. Resp. Br. pp. 38-39.

Under the above *Steadman* factors, a permanent bar is not in the public interest and, thus, is unwarranted in this case. The ALJ's imposition of a bar should be reversed and the Division's request to increase that bar be denied.

C. <u>Even if the Division's interpretation of Section 203(f) is accurate, the time-limited bar should be vacated, not increased.</u>

Under the Division's reading of the statute, the ALJ had only two options under Section 203(f) with regard to a suspension or bar: (1) impose a suspension of up to 12 months, or (2) bar Mr. Malouf permanently. Div. Br. p. 9. It contests the Commission's power to enter any remedy in between.[15] This theory fails for three reasons.[16]

[15] Following the Division's logic, it need only present sufficient evidence to justify a bar of 13 months and the ALJ would be automatically bound to order a permanent bar under Section 203(f). This incredibly technical and impractical reading of Section 203(f) runs contrary to the Supreme Court's opinion that securities laws "should be construed 'not technically and restrictively but flexibly to effectuate [their] remedial purposes.'" *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87(1983) (quoting *SEC v. Capital Gains Research Bureau*, Inc., 375 U.S. 180, 195 (1963) (punctuation in original).

The Division's logic further fails to comport with the *Steadman* analysis itself, which is designed to consider whether, under the specific facts and circumstances presented, the public would benefit from a respondent's removal from the industry. Because *Steadman* directs the Commission to weigh a multitude of factors, it necessarily implies a sliding scale of results based on the totality of the findings. The Division's reading of Section 203(f) fails to allow for the proper implementation of the *Steadman* factors and instead suggests that only two potential, and dramatically different, outcomes are permitted.

Finally, the Division's reading ignores the existence of previous instances in which an ALJ has imposed a time limited bar under Section 203(f). *In the Matter of Bruce Lieberman, Respondent.*, Release No. 2517 (May 26, 2006) (imposing a three year bar under Section 203(f)).

[16] This assumes, again, that a suspension or bar is warranted at all.

First, the Division has already sought, and failed to prove, that a permanent bar was warranted in this case under the public interest factors set forth in *Steadman*. Regardless of what Section 203(f) establishes as the *minimum* bar which an ALJ is authorized to impose, it is clear that the Division failed to set forth sufficient evidence that a permanent bar (i.e., the maximum bar) was warranted. Accordingly, if the Commission accepts the Division's reading of the Section, and finds the seven-and-one-half-year suspension period to be unauthorized, the proper cure is to award a sanction properly aligned with the evidence presented. While Mr. Malouf maintains that no sanction is warranted, the Division's failure to present evidence that would support a permanent bar means that the maximum suspension that can be imposed by the Commission under Section 203(f) is 12 months.

Second, the Division's argument in support of a permanent bar simply reasserts the same (losing) proffer made during the hearing, founded upon its belief that Mr. Malouf acted with a "high degree of scienter." Div. Br. p. 15. The evidence presented belies this assertion and, to the contrary, showed: (1) at all times, Mr. Malouf reasonably believed that he and the Firm were in compliance with the applicable rules and requirements; (2) Mr. Malouf appointed an experienced and knowledgeable CCO; (3) the Firm retained experienced and reputable outside compliance consultant to advise the Firm; and (4) there is no customer harm. Under the above factors, the imposition of *any* sanction, including a bar, is not aligned with the public interest. The Division's request should be denied.

Third, and finally, the Division's request for a permanent bar should be rejected because there is zero opportunity for future violations. Indeed, the ALJ concluded that the underlying conduct, all of which arose out of the sale of the branch to Mr. LaMonde, "[had] now passed and [was] unlikely to recur." Initial Decision. p. 43.

In light of the above, the Division's request for a permanent bar should be denied.[17]

D. Disgorgement of the installment payments is not warranted.

The Division also seeks have Mr. Malouf disgorge the installment payments he received in exchange for selling his branch office to Mr. LaMonde. The Division contends that these payments constitute "ill-gotten gains" which "unjustly enriched" Mr. Malouf. Div. Br. p. 16. This theory is belied by the evidence and was expressly (and emphatically) rejected by the ALJ.

1. The ALJ properly found that the installment payments were not commissions, but were legal profits.

The ALJ correctly (and soundly) concluded that branch installment payments were "***clearly identifiable*** as ***legal profits***, and should not be the subject of disgorgement." Initial Decision p. 43; (emphasis added). Moreover, based on the evidence presented, the ALJ easily distinguished installment payments, like those made by Mr. LaMonde, from "commissions" (as the Division had argued):

> I find that Lamonde's payments to Malouf, based on the profitability of the branch, and other sources, do not meet the definition of transaction-based compensation.... The Division's claim that Malouf received commissions is challenged by the fact that, among several dozen transactions at issue, the hearing evidence does not clearly tie particular payments made to Malouf, by Lamonde, to specific trades that Malouf was involved in.
>
> ***
>
> Because the Division could not validate its commission theory based on specific trades, it instead attempted to prove that Malouf received commissions based upon the similarity between the total payments, on the one hand, and the total commissions, on the other, generated over three years. However, measured quarterly,

[17] The Division's argument that the time-limited bar would expire "like a suspension" and allow Mr. Malouf to magically become re-registered without application runs contrary to 17 C.F.R. § 201.193 which governs Applications by Barred Individuals and speaks only to instance "where a Commission order bars the individual from association with a registered entity." The rule does not differentiate between individuals subject to permanent versus time-limited bars.

> the payments to Malouf vary significantly from the commissions generated and appear inconsistent with an agreement to pass all commissions along.
>
> ***
>
> So, when Lamonde received commissions from his broker activity related to UASNM, and then used them to make payments for Branch 4GE, those would be commissions received by Lamonde, not Malouf; and, in my mind, installment payments for the sale of a business as they were made to Malouf. Malouf was also paid from other sources than Branch 4GE, which were clearly not commissions. Yet, Lamonde is presumably permitted to spend his commissions as he sees fit, such as satisfying outstanding payments for his purchase of the broker-dealer branch.

That is, the ALJ rightly found that while the amounts earned by Mr. LaMonde on customer transactions were commissions, which did not, in turn, make Mr. LaMonde's payments to Mr. Malouf – made pursuant to a separate purchase agreement – commissions. Indeed, nearly all income earned by Mr. LaMonde's branch would likely have been sourced from commissions earned on customer transactions. But, the fact that his income originated from commissions does mean that subsequent business expenses paid with that income – rent, utilities, employees – were also "commission" payments. The ALJ rightly identified this obvious distinction and rejected the Division's notion.

In addition to finding the payments were not "commissions," the ALJ further concluded that the payments themselves were not "ill-gotten" but were "legal profits" that Mr. Malouf earned pursuant to the sales agreement with Mr. LaMonde. Decision p. 43. Accordingly, because the Division failed to establish (and cannot establish) that the installment payments received from Mr. Malouf were "ill-gotten profits," disgorgement is unwarranted.

2. The Division did not contest the ALJ's finding.

Moreover, while the Division contests the ALJ's denial of its request to require that Mr. Malouf disgorge the installment payments, it did not contest the Judge's ruling that the installment sale, and the payments made to Malouf thereunder, were, in fact, legal payments made pursuant to a permissible sales agreement. Because the Division has not challenged the propriety of the branch sale, or the compensation derived therefrom, it cannot sustain its argument that the amounts are somehow "ill-gotten" or "illegal." Accordingly, its request for disgorgement should be denied.

3. The Division's request for disgorgement is flagrantly punitive.

Finally, disgorgement is a remedial – not punitive – function intended to recoup "ill-gotten" gains derived from illegal conduct. *S.E.C. v. Drexel Burnham Lambert Inc.*, 837 F. Supp. 587, 611-612 (S.D.N.Y. 1993). *S.E.C. v. Bilzerian*, 814 F. Supp. 116, 120 (D.D.C. 1993), *aff'd*, 29 F.3d 689 (D.C. Cir. 1994; *S.E.C. v.Huff*, 758 F. Supp. 2d 1288, 1358(S.D.Fla. 2010), *aff'd*, 455 Fed. Appx. 882 (11th Cir. 2012) ("Because disgorgement is remedial and not punitive, a court's power to order disgorgement extends only to the amount with interest by which the defendant profited from his wrongdoing.") (emphasis added).

Here, the Division's request is solely punitive. It does not seek to remedy an unjust enrichment (no party was unjustly enriched by the legal sale of the Branch), or to recover "ill-gotten" gains (as the ALJ has concluded the payments were proper), but to punish Mr. Malouf further. Such a request runs contrary to the justification behind disgorgement as an acceptable remedy. Indeed, were Malouf forced to disgorge all monies he received from LaMonde, he would have received *nothing* for the sale of Branch 4GE.

IV. CONCLUSION

Based on the facts and authority set forth herein, and in Mr. Malouf's Brief in Support of his Petition for Review, Mr. Malouf respectfully requests that the Commission:

(1) Reverse the findings and conclusions in the Initial Decision that Mr. Malouf violated Securities Act Sections 17(a)(1) and 17(a)(3), Exchange Act Section 10(b) and Rules

10b-5(a) and 10b-5(c) and Advisers Act Sections 206(1) and (2); 206(4) and 206(4)-1(a)(5) and Section 207;

(2) Reverse the finding of aiding and abetting liability; and

(3) Vacate the award of sanctions, including the Cease and Desist Order, Civil Monetary Penalty, and Industry Bar.

(4) Deny the Division's Cross-Petition in its entirety.

Respectfully submitted October 15, 2015,

Ulmer & Berne LLP

Alan M. Wolper
awolper@ulmer.com
Heidi VonderHeide
hvonderheide@ulmer.com
500 West Madison Street, Suite 3600
Chicago, Illinois 60661
(312) 658-6500 – General
(312) 658-6565 – Fax

Counsel for Respondent

CERTIFICATE OF SERVICE

I hereby certify that Respondent's Reply In Further Support Of Petition For Review And Response To Division's Brief In Support Of Cross-Petition For Review has been sent to the following parties entitled to notice as follows:

Securities and Exchange Commission
Office of the Secretary
100 F. Street N.E.
Washington, D.C. 20549
Mail Stop 1090
Fax: 202-772-9324
(One copy via fax; original and three copies via Federal Express)

Honorable Jason S. Patil
Administrative Law Judge
100 F Street N.E., Mail Stop 2582
Washington, D.C. 20549
ALJ@sec.gov
(one copy via federal express; courtesy copy via e-mail)

Stephen C. McKenna
Dugan Bliss
Securities and Exchange Commission
Byron G. Rogers Federal Building
1961 Stout Street, Suite 1700
Denver, CO 80294-1961
Fax (303) 297-3529
mckennas@sec.gov
(One copy via fax; via Federal Express and via email)

This 15th day of October, 2015.

Alan M. Wolper

CERTIFICATION

I, Alan M. Wolper, counsel for Respondent Dennis Malouf, hereby certify that this brief complies with the length limitation set forth in Rule 450(c) and contains 6,842 words.

Alan M. Wolper