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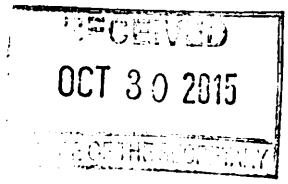
UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-15918

In the Matter of

DENNIS J. MALOUF

DIVISION OF ENFORCEMENT'S REPLY BRIEF IN SUPPORT OF ITS CROSS-PETITION FOR REVIEW

INTRODUCTION

Malouf's Response to the Division's Brief in Support of Cross-Petition for Review ("Response") does not seriously refute the Division's claim regarding Section 203(f) of the Adviser's Act. And his argument against disgorgement of the entire $1,068,084 in payments he received from Lamonde ignores the fact that those payments created an undisclosed conflict of interest and were received in violation of his fiduciary duty to seek best execution.

ARGUMENT

I. Malouf does not seriously rebut the Division's claim that, under Section 203(f) of the Advisers Act, associational bars must be permanent, whether with or without an explicit right to reapply.

Malouf's challenge to the Division's reading of Section 203(f) of the Advisers Act is limited to a footnote, wherein he argues that the Division's position is contrary to the Supreme Court's instruction that the securities laws be construed "'flexibly to effectuate [their] remedial purposes,'" and inconsistent with the application of the *Steadman*[1] factors which, according to Malouf, "necessarily impl[y] a sliding scale of results based on the totality of the findings." Response at 15 n.15. In essence, both arguments assert that absent authority to impose time-limited bars, the Commission would be unable to appropriately tailor its sanctions under Section 203(f). Malouf also claims that the Division's position ignores prior Commission practice, citing *In the Matter of Bruce Lieberman*, as a purported example of an ALJ-imposed time-limited bar under Section 203(f). *Id.* These arguments are unpersuasive, and reflect a misunderstanding of Commission practice.

Malouf disregards the Commission's many means of tailoring sanctions under Section 203(f) to individual respondents' misconduct. First, Section 203(f) provides a range of available

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[1] *Steadman v. SEC*, 603 F.2d 1126 (5th Cir. 1979).

sanctions, which increase in severity from (1) a censure or (2) a placing of limitations, to (3) a suspension from associating with regulated entities for a period of up to twelve months or (4) a bar from association. If a respondent's misconduct is not sufficiently serious to preclude association, the Commission may elect to simply impose a censure or limit the respondent's responsibilities while associated. Second, if the Commission concludes that a person's misconduct is sufficiently serious to warrant an interruption in their association, but does not rise to a level necessitating the Commission's exercise of its gatekeeper function in the future, the Commission may suspend a person's association for any period up to twelve months. At the expiration of a suspension, the person may immediately resume association without further regulatory action.[2] Only if, after considering and weighing the *Steadman* factors, the Commission is convinced that a person should be prevented from associating for more than twelve months *and* should not be free to re-enter the securities industry without Commission (and/or SRO) scrutiny of the circumstances, will the Commission impose a bar.

If the Commission concludes that a bar is appropriate, it may further tailor its sanction by imposing a qualified bar, which grants the respondent an explicit right to reapply for association after a specified period. This practice reflects the Commission's recognition that at some point in

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[2] That automatic expiration is the key distinction between a suspension and a bar is made particularly clear by comparing Section 203(f) to a similar provision contemporaneously adopted by Congress as part of the Securities Investor Protection Act of 1970 ("SIPA"). *See* Securities Investor Protection Act of 1970, Pub. L. No. 91-598, 84 Stat. 1636 (Dec. 30, 1970). SIPA was signed into law sixteen days after the Investment Company Amendments Act of 1970, which added Section 203(f) to the Advisers Act. *See* Division's Response at 11 n. 8. Section 10(b) of SIPA provided, in relevant part that "[t]he Commission may by order *bar or suspend for any period,* any officer [or other specified person] of any broker or dealer for whom a trustee has been appointed ... *from being or becoming associated with a broker or dealer....*" Pub. L. No. 91-598, § 10(b), 84 Stat. 1636, 1655 (Dec. 30, 1970) (emphasis added). The SIPA provision makes clear that the difference between a bar and a suspension is something other than duration, because otherwise, the SIPA language would be internally redundant. That difference is that unlike a suspension, a bar is permanent and cannot expire by its own terms. If Congress had intended a time-limited prohibition of more than twelve months to be an available remedy under Section 203(f), it would have drafted the provision that way, as it did in SIPA.

the future, with proper safeguards in place, it may be consistent with the public interest to allow the barred individual to resume work in the securities industry, notwithstanding the bar (which remains in place).[3] Indeed, the example cited by Respondent – *In the Matter of Bruce Lieberman* – illustrates this point perfectly. Lieberman did not receive a time limited bar under Section 203(f), as Malouf claims, but rather a bar with a right to reapply for association after three years – a qualified bar.[4] Malouf's assertion that the Division's reading of Section 203(f) is "impractical" and would limit the Commission to ordering "only two potential, and dramatically different outcomes," is not supported by the statutory language, by Commission practice, or by his own example.[5]

II. Absent a reasoned challenge to the Division's reading of Section 203(f), Malouf offers unpersuasive arguments in opposition to a permanent bar.

Rather than mount a serious challenge to the Division's reading of Section 203(f) of the Advisers Act, Malouf argues that even if the Division's interpretation is accurate, the time-limited bar should be vacated, not increased. Response at 15. Malouf claims that because the hearing officer only imposed a seven-and-one-half year bar from association under Section 203(f), "the maximum suspension that can be imposed by the Commission under Section 203(f) is 12 months." *Id.* at 16. But this is simply not true where, by rule: "[t]he Commission may affirm, reverse,

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[3] *See* Final Rule Release, *Applications by Barred Individuals for Consent to Associate with a Registered Broker, Dealer, Municipal Securities Dealer, Investment Adviser or Investment Company*, Rel. No. 903, 1984 WL 547096, *2 (Mar. 16, 1984); *Applications for Relief from Disqualification,* Rel. No. 438, 1975 WL 160468, *1 (Feb. 26, 1975).

[4] The Commission ordered: "Pursuant to Section 203(f) of the Advisers Act, that Respondent Lieberman be, and hereby is barred from association with any investment adviser with the right to reapply for association after three years to the Commission." *In the Matter of Bruce Lieberman*, Release No. 2517 at 2 (May 26, 2006).

[5] Malouf's assertion that the absence of any reference in SEC Rule of Practice 193 to time-limited bars supports an inference that the Rule would govern an individual's reapplication at the expiration of such a bar (Response at 17 n. 17) ignores the more obvious and logical interpretation of this omission: that the Commission does not impose time-limited bars.

modify, set aside or remand for further proceedings, in whole or in part an initial decision by a hearing officer and may make any findings or conclusions that in its judgment are proper and on the basis of the record." 17 C.F.R. § 201.411(a). The Commission is not bound by the hearing officer's findings.

Moreover, Malouf's claim that the hearing officer's time-limited bar precludes anything more than a twelve month suspension ignores the fact that the Division's evidence was sufficient for the hearing officer to find that a severe bar "is necessary to serve the public interest." I.D. at 43.

Malouf's further arguments that he did nothing wrong completely ignore his own culpability for not disclosing a serious conflict of interest he admits having, as laid out in the Division's Response. That culpability also refutes Malouf's claim that he adequately or reasonably delegated responsibility for UASNM's compliance functions to Kopczynski.

Malouf did not tell Kopczynski that Malouf had a conflict or that it needed to be disclosed on the Forms ADV and website. And even if he had, that would not be enough. Under his own argument, he would still be required to check to ensure that Kopczynski was performing his duties in a reasonable manner by making the required disclosure. Response at 3 ("Did the delegator (Mr. Malouf) ensure that Mr. Kopczynski was performing his duties in a reasonable manner?"). Malouf, despite acknowledging that he reviewed both the Form ADVs and the website, did nothing for over three years to ensure that his conflict was disclosed. His delegation defense thus fails because he had reason to know that Kopczynski had not properly performed Malouf's purportedly delegated duties. *See id.*, (delegator must "neither know[] nor ha[ve] reason to know that such person is not properly performing his or her duties").

None of this is addressed anywhere in Malouf's Response. Nor is the fact that Malouf's fraud resulting from his failure to seek best execution is an independent basis for sanctions.[6]

As addressed in the Division's Response, a permanent bar under Section 203(f) of the Adviser's Act is fully justified and in the public interest. Malouf's argument to the contrary is largely that "his conduct was neither 'egregious' nor performed with scienter," but rather he "acted in good faith." Response at 14. But this argument only shows that Malouf fails to recognize the wrongful nature of his conduct and can give no sincere assurance against future violations.

While it is true that a past violation, without more, is not sufficient to impose a bar, Malouf is wrong that the Division must prove that a bar "will deter future misconduct." *See* Response at 14. Rather, the Commission must consider the potential for future misconduct. *Tzemach David Netzer Korem*, Exch. Act Rel. No. 70044, 2013 SEC LEXIS 2155, at *23 n.50 (July 26, 2013). Here, Malouf's past conduct, coupled with his current role as the owner of another investment advisory firm and the other *Steadman* factors, indicate that an unqualified bar is in the public interest.[7]

III. Full disgorgement of Malouf's ill-gotten gains is warranted because his profits were made in violation of the securities laws.

Malouf argues that the hearing officer found the payments he received in breach of his fiduciary duties to be "legal profits" earned pursuant to a legitimate branch sales agreement with Lamonde. Response at 17-18. Because the hearing officer did not find the payments to be commissions or transaction-based compensation, and the Division did not appeal that specific

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[6] Malouf's repeated complaints that no action was brought against Kopczynski individually carry no weight because, as noted in the Initial Decision, "the Commission's decision not to pursue charges against [Kopczynski or Hudson] is an unreviewable exercise of prosecutorial discretion." I.D. at 23, citing *Greer v. Chao*, 492 F.3d 962, 964 (8th Cir. 2007).

[7] These facts also belie Malouf's claim that "there is zero opportunity for future violations." Response at 16.

finding, Malouf disclaims any obligation to disgorge the full amount of the payments he received pursuant to his fraud. *Id.* While these points might be relevant if this appeal involved issues of whether Malouf acted as an unregistered broker, they are irrelevant here. Even if Malouf was receiving payments pursuant to a legal agreement, those payments created a conflict of interest that was not disclosed to investors, and were made from funds generated by bond trades for which Malouf did not seek best execution, making the receipt of those payments illegal under the securities laws. That is the basis of the Division's appeal as to disgorgement.

The hearing officer's disgorgement calculation is fundamentally flawed because it does not take into account that Malouf's profits were obtained from two distinct but concurrent illegal activities: (1) Malouf failed to disclose that his "agreement with Lamonde created a conflict of interest for Malouf" (I.D. at 30); and (2) "Malouf violated his fiduciary duty by failing to seek best execution for UASNM's clients" (I.D. at 32). Because Malouf's profits were obtained from activities that violate the securities laws, they should be disgorged to deprive Malouf of the fruits of his illegal conduct. *See SEC v. Fischbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997).

Malouf's argument that the Division's request for full disgorgement is somehow punitive fails as a matter of law. Disgorgement does not serve a punitive function and may not exceed the amount obtained through the wrongdoing. SEC v. *Cavanagh,* 445 F.3d 105, 116 n. 25 (2d Cir. 2006).

CONCLUSION

For the reasons set forth herein and in the Division's Response, Malouf should be subject to an unqualified bar from association and ordered to disgorge the full $1,068,084 he received by way of his fraud.

Respectfully submitted this 29th day of October, 2015.

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SERVICE LIST

On October 29, 2015, the foregoing **DIVISION OF ENFORCEMENT'S REPLY BRIEF IN SUPPORT OF ITS CROSS-PETITION FOR REVIEW** was sent to the following parties and other persons entitled to notice:

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CERTIFICATION

I, Stephen McKenna, counsel for the Division, hereby certify that I ran Microsoft "Word Count" on this brief exclusive of the caption, signature block and certificate of service, and the brief contains1,607 words.

Stephen McKenna