ORIGINAL

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16033

In the Matter of

AIRTOUCH COMMUNICATIONS, INC., HIDEYUKI KANAKUBO, AND JEROME KAISER, CPA,

Respondents.

THE DIVISION OF ENFORCEMENT'S PREHEARING BRIEF

February 3, 2015

Division of Enforcement
Securities and Exchange Commission
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I. INTRODUCTION

The Division of Enforcement ("Division") brings this case against Jerome Kaiser ("Kaiser"), a CPA and the former CFO of AirTouch Communications, Inc. ("AirTouch"), a now-defunct public company that made wireless routers, for violations of the antifraud provisions of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").[1]

The evidence will show that Kaiser committed two egregious frauds: one, an accounting fraud, resulting in AirTouch misstating *all* of its third quarter revenue in 2012 (more than $1 million of false revenue); the second, an offering fraud, resulting in the fraudulent inducement of a $2 million loan. Both frauds stemmed from Kaiser's knowing distortion, and active concealment, of AirTouch's true business dealings with a Florida company, TM Wireless Communications Services ("TM Cell"). In Kaiser's fraudulently constructed distortion, AirTouch earned revenue from shipping product to TM Cell. In reality, AirTouch did not sell anything to TM Cell, and TM Cell did not pay a dime to AirTouch.

[1] AirTouch and its former CEO, Hideyuki Kanakubo, also named as respondents, agreed to an order issued on January 30, 2015, to cease and desist from committing or causing any violations of the Securities Act and Exchange Act antifraud provisions; requiring Kanakubo to pay civil penalties and disgorgement; and barring Kanakubo as a public company officer or director for five years. *See In re AirTouch Commc'ns, Inc., et al.*, SEC Rel. No. 3625, 2015 WL 399948 (Jan. 30, 2015).

Accounting fraud. Although Kaiser caused AirTouch to record revenue for the shipment of AirTouch routers to TM Cell in the third quarter of 2012, the only thing TM Cell agreed to do was warehouse that inventory for a fee. That warehousing arrangement was governed by a three-page written contract, with which Kaiser was intimately familiar and directed AirTouch's former CEO to sign. The contract stated that TM Cell would only have to pay AirTouch for the inventory if AirTouch ever managed to sell it to an actual customer, and that customer paid TM Cell (rather than AirTouch directly) for it.

Despite this, Kaiser identified the shipments to TM Cell as an opportunity for AirTouch—a financially inept company struggling to bring its products to market—to report revenue in third quarter 2012. Since the contract's terms plainly precluded any recognition of revenue based solely on the mere shipment of product to TM Cell, Kaiser embarked on a sustained effort to conceal the contract from AirTouch's controller, independent auditors and outside directors.

With AirTouch's gatekeepers in the dark regarding TM Cell's role as a warehouser, Kaiser caused AirTouch to falsely report positive revenues in the Form 10-Q for third quarter 2012— results he certified as the CFO. When the contract finally came to light following an internal investigation, the gatekeepers quickly recognized that the entire third quarter revenue should never have been

recorded. In early 2013, AirTouch announced its intent to restate its financial results.

Very little of the Division's accounting fraud claim can be disputed. Given AirTouch's withdrawal of its results based on improper accounting, there can be no dispute that Kaiser made false statements when he certified the reported revenues and compliance with generally accepted accounting principles ("GAAP") and company revenue recognition policy. Nor can the materiality of Kaiser's false statements be seriously questioned. The more than $1 million in falsely recorded revenues represented 100% of AirTouch's reported revenues for third quarter 2012.

Offering fraud. Kaiser's distortion of AirTouch's relationship with TM Cell animates the Division's second set of claims, which derive from his fraudulent representations and scheme to defraud the family of shareholder Tony Tang. At the same time AirTouch was disclosing the third quarter 2012 financial results, in inducing the Tangs to loan AirTouch needed capital, Kaiser misrepresented the true nature of the company's relationship with TM Cell and its business with Mexican telecommunications provider, Telefonos de Mexico SAB de CV ("Telmex"), which AirTouch was hoping would someday place large orders for its products. Kaiser concealed the TM Cell contract from Tang and his representatives, who plainly would have wanted to know that TM Cell was not

buying anything from AirTouch. Kaiser lulled Tang into believing that AirTouch was shipping inventory to TM Cell because Telmex had purchased the product, while knowing that AirTouch had no substantial orders from Telmex. Kaiser's fraudulent inducements led the Tang family to loan AirTouch $2 million, in exchange for a promissory note and warrant to purchase AirTouch common stock.

Like Kaiser's accounting fraud, much of the Division's evidence regarding Kaiser's offering fraud will be difficult to refute. Given that AirTouch's repayment obligations to the Tang family were tied explicitly to AirTouch's sales, Kaiser's misstatements and omissions about AirTouch's relationships with TM Cell and Telmex were patently material.

Scienter. The Division's accounting fraud claims require proof that Kaiser either intentionally or recklessly misstated AirTouch's third quarter 2012 revenue; its offering fraud claims require proof that he either intentionally or recklessly deceived Tang, or negligently defrauded him, in securing the $2 million loan. The evidence will more than sufficiently establish Kaiser's *mens rea*. Kaiser has been a CPA for decades, and has held numerous positions in auditing and financial reporting. Knowing the terms of the TM Cell contract, Kaiser surely understood that no revenue could be recorded based merely on shipments to its warehouse. Yet he determined to book revenues off of these shipments, and touted these results to secure the Tang loan. Numerous aspects of Kaiser's knowledge and

conduct will show that his acts were intentional, or deliberately reckless, with respect to the accounting fraud, and, at a minimum, negligent with respect to the offering fraud.

First, Kaiser's real-time involvement in the negotiation and execution of AirTouch's contract with TM Cell will show that he knew the contract governed AirTouch's shipments of product to TM Cell, and that TM Cell was not buying any product from AirTouch.

Second, Kaiser was party to numerous discussions after the contract was signed where he acknowledged—during the third quarter of 2012—that the inventory in TM Cell's warehouse remained unsold.

Third, despite his knowledge of its significance, Kaiser concealed the contract from important gatekeepers of the company's financial reporting. By deleting it from emails, refusing to provide it when asked, and feigning ignorance of its very existence, Kaiser prevented AirTouch's internal controller, independent auditors, and outside directors from learning of the TM Cell contract prior to the issuance of third quarter 2012 results.

Fourth, Kaiser's motive to misstate AirTouch's revenues and business relationships was plain. Kaiser was acutely attuned to the company's need for positive results, given AirTouch's desperate financial condition, which jeopardized its ability to continue as a going concern. Kaiser continually exerted pressure on

AirTouch employees to obtain purchase orders and sales, which he expressly associated with the company's ability to raise additional capital (including from Tang) and stay afloat.

Sanctions. At the hearing on this matter, the Division will prove by a preponderance of the evidence that Kaiser violated the antifraud provisions of the Securities Act and Exchange Act, and that the public interest requires the imposition of significant sanctions against Kaiser. The Division seeks a cease-and-desist order, disgorgement plus prejudgment interest, third-tier civil penalties, an officer and director bar, and a practice bar under Commission Rule of Practice 102(e).

II. STATEMENT OF FACTS

A. Background

AirTouch. While operational, AirTouch developed and sold consumer telecommunications equipment to integrate mobile phones into landline telephone systems. In early 2012, AirTouch introduced its "SmartLinx U250" product, designed to allow consumers to initiate calls through their smart phones via an existing landline connection. AirTouch developed the U250 in response to a request from Telmex, the largest landline telephone carrier in Mexico.

AirTouch's CEO, Hide Kanakubo, founded AirTouch's predecessor, Waxess USA, Inc. ("Waxess"). Waxess effected a reverse merger with a public

company shell on February 4, 2011, and subsequently acquired the license to the "AirTouch Communications, Inc." name.

Kaiser. Kanakubo hired Kaiser in 2010 as the CFO first of Waxess, then AirTouch. A CPA for approximately 30 years, Kaiser first obtained his California license in 1985. Before joining AirTouch, he served as the audit director, controller and/or chief financial officer of several other public and private companies, and as staff accountant and senior staff accountant in PricewaterhouseCooper's audit group.

Kaiser and AirTouch's controller, Sylvia Chan, whom he supervised, were the two people responsible for finance and accounting at AirTouch. Kaiser played the predominate role, with Chan, despite her title, serving primarily as a bookkeeper. Kaiser was responsible for all the company's financial and accounting functions, including preparation of financial statements and SEC reporting requirements. The evidence will show that Kaiser was hands-on operationally, frequently inserting himself into the company's sales activity.

Gatekeepers. AirTouch's board included three independent directors: Steve Roush, James Canton and Larry Paulson. Roush was the chair of the audit committee; Canton acted as chair of the board's compensation committee; and Paulson as the Chairman of the board.

Anton & Chia LLP was AirTouch's independent audit firm. Greg Wahl, one of its founding partners, was the engagement partner for AirTouch; audit manager Tommy Shek managed the day-to-day audit of AirTouch's financial results.

B. Kaiser Knew That 100% of AirTouch's Third Quarter 2012 Revenues Were False When Reported

1. Desperate for cash, AirTouch revamped its sales plan to focus on the untested "U250"

By mid-2012, AirTouch was in precarious financial condition, marked by liquidity concerns and weak sales results. In its quarterly reports for the first two quarters of 2012, AirTouch warned that if it did not generate additional revenues or otherwise raise capital, it might not continue as a going concern. Kaiser, who held an option to purchase nearly 200,000 shares of AirTouch's common stock, was anxious to generate sales to increase the company's stock price and continue operations.

While Telmex expressed interest in AirTouch's U250, it insisted on conducting extensive product "testing" before committing to purchase large amounts. Telmex placed an order for 2,000 units of U250 in May 2012, informing AirTouch representatives, including Kaiser, that it "expected" to purchase 18,000 additional pieces if the testing and marketing of the first 2,000 units succeeded in the testing phase. Despite this, AirTouch identified the U250 as its "primary

revenue driver" for second quarter 2012. Ultimately, Telmex bought only 2,420 units total.

2. AirTouch management used purchase orders to secure financing for manufacturing and to demonstrate progress

Purchase orders were critical for AirTouch's business. AirTouch used EMI Asia Ltd. ("EMI") of Hong Kong to manufacture the U250. Because of its cash flow situation, AirTouch could not afford to pay EMI to manufacture the goods without financing. So AirTouch used a factoring company, Olympus Business Creation America, Inc. ("Olympus"), to finance EMI's manufacturing.

As part of this arrangement, Olympus needed proof that AirTouch actually had demand before it would provide financing. Olympus would often require AirTouch to provide actual purchase orders from customers, to assure Olympus that AirTouch would eventually be able to repay Olympus. Once that evidence was provided, Olympus would pay EMI to manufacture the U250s and release the product to an AirTouch-designated freight forwarder. After AirTouch collected on the customer sales, it would reimburse Olympus and pay the factoring charges.

3. Under Kaiser's direction, AirTouch tried, but failed, to secure a contract and contingent "purchase order" from Celistics

Following limited shipments of product to Telmex for product testing in the late spring and early summer 2012, Telmex representatives informed AirTouch that any future business would require a third-party intermediary with shipping and

logistics capabilities, since AirTouch did not have the infrastructure in place to ensure timely and efficient delivery of the product from EMI in China to Telmex subscriber homes in Mexico.

By July, AirTouch management, in projections, had identified Telmex as a potential purchaser of hundreds of thousands of U250 units over the next year. To comply with Telmex's request for a third party intermediary, AirTouch entered into negotiations with Celistics. Carlos Isaza, AirTouch's Vice President of Sales for Latin America, was AirTouch's primary point of contact with Celistics, which maintained a warehouse presence in Mexico.

AirTouch had, since April of 2012, been negotiating a potential equity investment and/or distribution agreement with Celistics, under Kaiser's supervision. By July, neither of those deals had come to fruition. So from its inception in mid-July, the Celistics logistics proposal featured AirTouch shipping inventory to Celistics—ultimately bound for Telmex—pursuant to a Celistics "purchase order" that the parties' proposed agreement stated Celistics would issue. Although Celistics would issue a "purchase order" to AirTouch under the proposed agreement, Celistics expressly had no obligation to pay AirTouch, unless and until Telmex ordered the inventory and paid Celistics for it. Kaiser, over the course of numerous communications with Isaza and others, was aware that Celistics would not issue AirTouch a "purchase order" until the parties executed an agreement

stating that Celistics' payment obligation was contingent on AirTouch selling the product to Telmex, and Telmex paying Celistics.

Kaiser asked AirTouch's outside counsel, Daniel Donahue of Greenberg Traurig, to draft a form letter agreement memorializing the demands Celistics had made in what Kaiser referred to as a "term sheet." Kaiser received the draft Celistics agreement from Donahue on or about July 24, 2012. That draft agreement stated unambiguously, consistent with Kaiser's direction to Donahue, that Celistics "shall not be obligated to pay AirTouch until the Products have been received by Telmex and Celistics has received payment therefor."

Even though it was clear that Celistics would not be buying the inventory, but merely storing it pending a hoped-for purchase by Telmex, Kaiser expressed urgency to conclude the Celistics negotiations. He wanted to obtain a "purchase order" from Celistics by month-end, in part to provide Olympus with a "purchase order" so it would release the manufactured inventory from EMI. Isaza cautioned Kaiser not to press Celistics too hard for a "purchase order," noting that the "purchase order" AirTouch was requesting needed to be "part of the process" of giving Celistics comfort, via a contract, that Celistics would never be obligated to pay AirTouch for the U250 if AirTouch's sales efforts to Telmex failed.

4. Under Kaiser's direction, AirTouch instead secured a contract from TM Cell

As July 2012 drew to a close, pressure mounted within AirTouch to secure Celistics' agreement to take inventory from AirTouch. Kaiser was desperate to ship product out of EMI in China in order to show progress with respect to the U250.

When negotiations with Celistics stalled, Isaza contacted the principals of his former employer, TM Cell, on or about July 30, 2012, to try to obtain the same type of warehousing arrangement AirTouch had sought from Celistics. Unlike Celistics, TM Cell did not have any presence in Mexico, nor was it an approved Telmex distributor. But TM Cell could provide AirTouch with warehousing capabilities in South Florida.

The negotiations with TM Cell took just a single day, on July 30th, and just as during the Celistics discussions, it was clear from the outset that TM Cell was not purchasing any product from AirTouch. Kaiser was fully aware of this. In fact, Kaiser personally directed Isaza to use the draft Celistics contract as the starting point with TM Cell. He also gave Isaza real-time instructions over the course of the single day's negotiations, monitoring Isaza's discussions with TM Cell from start to finish.

TM Cell principals Frank Cheng and Mario Ego-Aguirre demanded several revisions to the draft contract, making even more clear they were not buying

anything from AirTouch. They demanded the contract also include provisions, for example, that AirTouch would pay TM Cell to store the products; that AirTouch bore responsibility for collecting from any customer who did not pay; and that TM Cell could unconditionally return any product AirTouch did not sell.

Kaiser was fully aware of these terms. Isaza sent TM Cell's revisions to Kaiser, who, in an email marked "URGENT," sent the revised agreement to Kanakubo, asking him to immediately review, sign and return the contract. In response, Kanakubo noted to Kaiser the deal's similarity to the Celistics proposal. Once Kanakubo signed the contract, Kaiser sent it to Isaza for signature by TM Cell. Kaiser then received the fully executed contract directly from Ego-Aguirre.

5. The contract clearly stated that TM Cell was not buying product from AirTouch

The final, signed contract explicitly stated that TM Cell was not buying any product from AirTouch. Paragraph 6 described the contingent nature of TM Cell's payment obligation, expressly stating that TM Cell did not have to pay AirTouch anything unless and until Telmex actually bought and paid for the inventory:

> [Paragraph] 6. Payment. TMCell shall pay for Products in 90 days in accordance with the payment terms invoiced by AirTouch. However, ***TMCell shall not be obligated to pay AirTouch until the Products have been received by Telmex and TMCell has received full payment therefor,*** at which time then TM Cell shall pay AirTouch for the Products within 10 days thereafter. In the event that Telmex and/or assigned customer from AirTouch does not pay for any reason whatsoever, ***it will be the responsibility of AirTouch to collect***

> ***the outstanding payment*** from Telmex and/or assigned customer from AirTouch.

(Emphasis added.) Although TM Cell "may" issue "purchase orders"—which AirTouch asked for—paragraph 3 made clear that these purchase orders were "subject to" Telmex or some other customer actually ordering the product. That provision also stated that TM Cell had the right to return any product shipped if Telmex or some other customer never "fulfills" the orders:

> [Paragraph] 3. Orders and Acceptance. TMCell may initiate purchases under this agreement by submitting written purchase orders to AirTouch. No purchase order will be binding upon AirTouch until accepted by AirTouch in writing. TMCell's purchase orders are ***subject to purchase orders by Telmex and/or any other customer that may be assigned from time to time by AirTouch. In the event Telmex or any of the customers does not fulfill the purchase orders and/or cancels the orders, TMCell shall have the right to return these products to AirTouch and obtain a full credit equal to the original purchase amount with no offsets or deductions of any kind.***

(Emphasis added.) Paragraph 5 set forth the fees that AirTouch would have to pay TM Cell for warehousing the product while AirTouch sought an actual customer:

> [Paragraph] 5. Resale to Telmex and/or assigned customers by AirTouch. ***TMCell shall store the merchandise until shipment of the Products and shall invoice AirTouch for storage of the products, in/out control, invoicing, stock reconciliation, at 1.5% of the invoice value for the first 30 days and an additional 1% for each additional 30 days....***

(Emphasis added.)

Thus, the only payment commitment under the contract was AirTouch's obligation to pay TM Cell for warehousing and logistics services. The contract did not obligate TM Cell to pay AirTouch until and unless AirTouch sold the product to a third party and that third party actually paid for it.

Even though TM Cell was not buying anything, AirTouch requested that TM Cell issue a "purchase order" for the products being stored at the TM Cell warehouse. AirTouch told TM Cell that this would allow it to track the shipments from China to Miami. This also allowed AirTouch to send the purchaser order to Olympus, so that EMI would release the product, and gave AirTouch management a purchase order to tout to the market.

Under paragraph 3 of the contract, TM Cell simultaneously issued a "purchase order" to AirTouch for 20,000 U250 units at a price of $87 per unit, which accompanied the signed contract. The "purchase order" reflected payment terms of "net 90" but stated "PMT terms according to term sheet." While the "purchase order" did not identify the "term sheet" by name, the evidence will show that TM Cell's reference to the "term sheet" alluded to the contract.

TM Cell explicitly conditioned the issuance of this "purchase order" on the execution of the warehousing contract—a fact Kaiser knew. As with the contract, Kaiser provided input on the drafting of the "purchase order." Also, in requesting Kaiser's approval of the final version of the purchase order, Isaza forwarded Kaiser

an email attaching the draft contract and a draft of the purchase order. In that email, Ego-Aguirre described the purchase order as "conditional to executing the Fulfillment and Logistics Agreement" and as expiring in 24 hours unless the agreement was signed.

6. Knowing that AirTouch's inventory was merely parked at TM Cell, Kaiser booked false revenues

During the third quarter ended September 30, 2012, AirTouch shipped 14,260 units to TM Cell under the contract and the accompanying "purchase order." At or around the time of each shipment to TM Cell's warehouse, AirTouch recognized revenues for those amounts. Kaiser was responsible for this revenue recognition determination; Chan booked the accounting entries at his direction. AirTouch booked these revenues despite the fact that TM Cell had incurred no obligation to pay AirTouch.

7. Kaiser concealed the contract from key gatekeepers

At no time did Kaiser reveal the contract's existence to Chan, let alone its governance of the terms of AirTouch's shipments to TM Cell. Kaiser's concealment of the contract began the day after it was signed. On July 31st, the day after Kaiser received Ego-Aguirre's email attaching the signed contract and purchase order, Kaiser forwarded the email to Chan, but deleted the contract, leaving only the purchase order attached. The evidence will show that Kaiser then rebuffed Chan's numerous attempts to obtain the contract before and after the

Form 10-Q was filed. Kaiser thus prevented any meaningful review by Chan of the propriety of AirTouch's accounting entries. Indeed, Chan did not see the contract until her investigative testimony in October 2013.

Nor did Kaiser apprise AirTouch's outside directors or outside auditors of the TM Cell contract. Despite AirTouch's receipt of its largest ever "purchase order" just days before, Kaiser made no mention of the TM Cell contract at the board's August 3, 2012 meeting. At the November 16, 2012 meeting, when the board reviewed AirTouch's third quarter results, the board materials reflected a $1,740,000 receivable from TM Cell in AirTouch's "A/R Aging Summary." Yet Kaiser did not reveal the existence of the contract at that board meeting either.

During Anton & Chia's third quarter review beginning in late October 2012, Kaiser's withholding of the contract persisted. When Chan asked Kaiser to provide her all material agreements for the auditors' review, Kaiser sent her a set of agreements that did not include the contract. When asked directly by the auditors for any material agreements during the third quarter planning meeting, Kaiser again failed to identify the contract. Kaiser hid the agreement a third time after that meeting, when the auditors asked Chan for additional documentation supporting the TM Cell journal entries. Kaiser still did not provide the contract to Chan for the auditors, despite that request.

8. Kaiser's communications during the third quarter show that he knew the TM Cell shipments were not sales

Kaiser's desire to obscure the contract is underscored by numerous communications reflecting his awareness—and dismay—that AirTouch continued to own the inventory that it was paying to store at TM Cell. For example, shortly after the first shipment to TM Cell, in an August 2012 email, Kanakubo wrote to Kaiser and others that, even though they had shipped 8,000 units to TM Cell, they still needed Telmex to actually buy and pay for the product, writing "[w]e need Telmex to issue us a PO for 8K ... so TM Cell can immediately turn around and ship them to Mexico." "Till then," Kanakubo concluded, "we need to sell and collect from Telmex." Similarly, in another telling exchange, Kanakubo described the TM Cell inventory to Kaiser and others as "ours until Telmex picks them up" and as "holding us a hostage."

Kaiser never disagreed with these assessments. Only days before AirTouch filed the Form 10-Q, Kaiser fantasized with Kanakubo about what an order from Telmex would mean, where Kanakubo explained by email that a Telmex order would allow AirTouch to "release" some of inventory warehoused at TM Cell, would give AirTouch a reason to ask TM Cell to generate a replenishment purchase order, and would then "generate continuous sales as if Telmex real sales chases the shipment and production flow."

9. Kaiser caused AirTouch to report illusory revenues, falsely certifying their accuracy

On November 14, 2012, AirTouch reported net revenues of $1,031,747 for the third quarter. Absent the $1,240,620 in revenues recognized on the shipments to TM Cell, the quarterly revenues would have been negative $208,873, due to other customers' returns that quarter.

Kaiser signed a management representation letter to Anton & Chia that accompanied the Form 10-Q, falsely averring, among other things, that the quarterly financial results were recorded in compliance with GAAP and contained no improperly recorded transactions.

Kaiser also provided a certification with the Form 10-Q. In that statutorily required document, Kaiser falsely certified that the Form 10-Q did not "contain any untrue statement ... or omit to state" any material facts, and that the quarterly financial statements "fairly present[ed], in all material respects the financial condition, results of operations and cash flows of the registrant."

10. Kaiser continued concealing the TM Cell contract during the audit committee's internal investigation

By late 2012, TM Cell's failure to pay AirTouch anything for the inventory it received in the third quarter drew the board's notice. Audit committee chair Steven Roush, himself a 39-year PricewaterhouseCoopers veteran, began questioning Kaiser why the receivable remained uncollected, despite 90 days

having passed. Finding Kaiser's responses lacking, Roush convened a board teleconference for January 18, 2013.

During the call, Kaiser stated that TM Cell would not pay AirTouch until AirTouch sold the product through to Telmex. Alarmed, Roush commenced an investigation. At no time during the January 18th meeting did Kaiser reveal the existence of the contract to the outside directors nor to outside counsel.

In the investigation that followed, at a time when the legitimacy of the reported revenues was already in question, Kaiser took several additional steps to impede the audit committee's understanding. First, on January 18, 2013, following the board call, Roush asked Kaiser for the TM Cell purchase order and "any other related documents" as well as for a contact at TM Cell. In response, Kaiser sent Roush solely the purchase order, making no reference to the contract. And despite his interactions with Cheng and Ego-Aguirre in the preceding months, Kaiser professed ignorance of AirTouch's TM Cell contacts.

Over the next week, Kaiser and Roush exchanged emails concerning TM Cell. At no time during these discussions did Kaiser provide Roush with the contract, despite Roush asking for a copy of the "term sheet" referenced in the purchase order. Instead, Kaiser denied that a "term sheet" had ever been finalized, attributing TM Cell's failure to pay to its "reconsider[ing] the payment terms" and to slower-than-expected orders from Telmex.

Ultimately, Roush obtained the contract not through Kaiser, but in spite of him. The evidence will show that after Roush scheduled a call with Kaiser and Isaza in late January 2013, Kaiser told Isaza to answer only the questions asked by Roush, and not to volunteer any information. After the call, when no mention was made of the contract, Kaiser complimented Isaza in an email for doing a "great job" on the call. The evidence will also show that Isaza and his boss, Quan, later called Roush, without telling Kaiser, and told Roush of the existence of the contract. Quan then sent the contract to Roush by email on January 27, 2013. This was the first time Roush received the contract, despite having had several discussions with Kaiser about the TM Cell receivable. Based on his review of the contract, Roush quickly concluded that the revenues were improperly recorded.

On January 28, 2013, after Roush had already received the contract from Quan, Kaiser at last forwarded it to him. Kanakubo had sent an email to Kaiser earlier that day, claiming "I found this." What Kanakubo had allegedly "found" and forwarded to Kaiser was a July 30, 2012 email exchange where Kaiser had personally asked Isaza to have TM Cell sign the agreement. Yet when Kaiser forwarded this email and the attached contract to Roush, he removed the part of the email exchange that he had with Isaza back in July—an exchange that undermined Kaiser's claim contrived claim that he was previously unaware of the agreement. After Kaiser at last forwarded the contract to audit engagement partner Greg Wahl,

Wahl responded that Anton & Chia had not previously received the contract. The auditors will testify that they too came to the rapid conclusion that revenues had been improperly recorded.

On January 31, 2013, the audit committee determined to restate the company's financial results, a decision approved by the board, with management's concurrence, on February 1, 2013. The same day, TM Cell, at its request, received a zero balance statement showing that it owed nothing to AirTouch.

11. AirTouch announced its intent to restate, but never did

On February 7, 2013, AirTouch announced, in a Form 8-K, that it intended to restate all of its revenues for the third quarter ended September 30, 2012 based on errors in revenue recognition. Kaiser signed the Form 8-K, and the evidence will show that Kaiser agreed with the decision to restate.

The Form 8-K disclosed that the audit committee had concluded that the revenues must be reversed because "shipments to one customer were improperly recognized as revenue in the aggregate approximate amount of $1.2 million for the quarter ended September 30, 2012."

No restatement or any subsequent financial results were ever filed, and AirTouch ceased operations after Kanakubo and Kaiser left the company in the spring of 2013.

C. Kaiser Falsely Induced a $2 Million Loan From the Tang Family

In addition to falsely reporting revenues in the company's third quarter Form 10-Q, Kaiser materially misstated the nature of AirTouch's relationships with TM Cell and Telmex to procure a $2 million loan from the family of AirTouch shareholder Tony Tang, in connection with which AirTouch issued a promissory note and a warrant to purchase 100,000 shares of common stock.

In the first nine months of 2012, the company faced an acute need for capital. In or around early 2012, Kaiser, along with Kanakubo, reached out to Tang to discuss a potential investment in the company. By summer 2012, the discussions coalesced around an offshore entity associated with Tang's family—Noble Field Overseas Limited—potentially providing AirTouch with a loan. Tang acted as the agent for this loan, and a firm known as WBT Resources served as investment bankers.

Kaiser was Tang's primary point of contact, and controlled the information provided by AirTouch to Tang and his representatives between August and October 2012. Kaiser concealed from Tang that AirTouch's largest "purchase order" was in fact illusory, containing no more than a contingent payment obligation associated with a paid warehousing service. Kaiser never provided Tang or his representatives the TM Cell contract. Moreover, Kaiser provided Tang misleading information about the TM Cell purchase order, suggesting that it was

actually from Telmex, and concealing that TM Cell's payment terms were contingent. Kaiser also received an email that Kanakubo had sent Tang, where Kanakubo had expressly stated that AirTouch had an order from TM Cell for 5,840 pieces at $87 per unit "off 20,000 pcs PO from Telmex" and that TM Cell was an "authorized fulfillment house for Telmex." Though both statements were false, Kaiser never corrected them.

Kaiser had ample motive to conceal the true nature of the relationship with TM Cell, since he viewed the influx of capital as necessary to salvage the company's stock price and continue operations. In addition to his general motive to keep AirTouch in business, Kaiser harbored a specific motive to complete the Tang family investment. Unbeknownst to the board's compensation committee, he received extra compensation from AirTouch tied to the closing. Two days after the loan closed, Kaiser instructed AirTouch's outsourced payroll provider to pay himself a $15,000 bonus "[o]n appreciation for his efforts in assisting the company in capital raising efforts on the Kowlowitz and Tang deals." This unauthorized payment did not come to the outside directors' attention until after his resignation.

The Tang family loan (signed by Kaiser for AirTouch) closed on October 17, 2012—and AirTouch was soon in arrears. AirTouch's repayment obligations tracked the number of unit sales following the date of the note. Specifically, for the U250, AirTouch agreed to repay the Tang family $10/unit from the first 25,000

U250 units sold, and $15/unit thereafter. By early 2013, AirTouch had missed two payments.

Following the restatement, Kaiser (and Kanakubo) met with Tang on February 22, 2013, hoping to raise additional capital. Kaiser falsely told Tang the agreement had only just been discovered. Tang, to whom the contingent nature of TM Cell's payment obligation and the absence of further orders from Telmex was material, responded by demanding accelerated repayment. AirTouch made no further payments.

III. LEGAL ARGUMENT – LIABILITY

The evidence will show that Kaiser, by the conduct described above, violated the antifraud provisions of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, and Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a). The Division will establish this by a preponderance of the evidence, the standard of proof in administrative proceedings. *See In re Sandra K. Simpson*, Exchange Act Rel. No. 45923, 55 S.E.C. 766, 2002 SEC Lexis 3419, at *57 (May 14, 2002) (Comm. op.); *SEC v. Steadman*, 450 U.S. 91, 102-03 (1981).

By causing AirTouch to report nonexistent revenues in its Form 10-Q for third quarter 2012, and hiding the warehouse contract to mask this false accounting, Kaiser violated the misrepresentation and scheme liability prohibitions of Section 10(b)/Rule 10b-5. Kaiser's falsehoods to Tang violated these same

provisions, and violated Section 17(a)'s prohibitions against misrepresentations and schemes to defraud in offerings.

A. By Knowingly Reporting False Revenues in AirTouch's Third Quarter Form 10-Q, and By Engaging in a Scheme to Falsely Inflate Earnings, Kaiser Violated Section 10(b) and Rule 10b-5

Section 10(b) of the Exchange Act and Rule 10b-5 make it unlawful to employ a device, scheme, or artifice to defraud; to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5(a)-(c). Rule 10b-5(b) prohibits any person "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading," in connection with the purchase or sale of a security. Therefore to establish a violation of Section 10(b) and Rule 10b-5(b), the Division must show that Kaiser, in connection with the purchase or sale of a security: (1) made an untrue statement or omitted to state a material fact, (2) with scienter. *See* 17 C.F.R. § 240.10b-5(b).

A statement or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988); *TSC Indus. v. Northway*, 426 U.S. 438, 450 (1976). Information about a company's financial condition is considered material. *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980). Anyone who "makes" a misleading statement or omission, or who has "ultimate authority over" it, can be liable under Rule 10b-5. *See Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011).[2]

Scienter may be shown through "either 'deliberate recklessness' or 'conscious recklessness'—a 'form of intent rather than a greater degree of negligence.'" *In re Verifone Holdings, Inc. Sec. Litig.*, 704 F.3d 694, 702 (9th Cir. 2012) (*quoting SEC v. Platforms Wireless Int'l*, 617 F.3d 1072, 1093 (9th Cir. 2010)); *SEC v. Steadman*, 967 F.2d 636, 641 (D.C. Cir. 1992); *see also Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990) (en banc). "[T]he ultimate question is whether the defendant knew his or her statements were false, or was consciously reckless as to their truth or falsity." *Gebhart v. SEC*, 595 F.3d

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[2] Kaiser "made" material misstatements because he signed the Form 10-Q. *See Howard v. Everex Sys.*, 228 F.3d 1057, 1061 (9th Cir. 2000); *see also SEC v. Das*, No. 8:10CV102, 2011 WL 4375787, at *6 (D. Neb. Sept. 20, 2011). An issuer's disclosures, made while its stock is trading, satisfy Rule 10b-5's "in connection with" requirement. *See, e.g., SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 860-61 (2d Cir. 1968).

1034, 1042 (9th Cir. 2010). Proof of recklessness may be inferred from circumstantial evidence. *SEC v. Burns*, 816 F.2d 471, 474 (9th Cir. 1987).

1. Kaiser made knowingly false statements and omissions concerning AirTouch's third quarter 2012 revenues

It is indisputable that the revenues reported in AirTouch's third quarter 10-Q were false. On February 7, 2013, AirTouch disclosed, via Form 8-K, that it had recognized revenue erroneously and would restate. Similarly, Kaiser's certifications—that AirTouch's financial statements complied with GAAP and were presented fairly with no material misstatements or omissions, and that the stated revenue figures in the periodic report had been recorded in compliance with AirTouch's internal revenue recognition policy—were false. The Division's expert, Dr. Jerry Arnold, CPA, will testify that there is no question that the third quarter 2012 revenue should never have been booked.[3]

It is also indisputable that investors would have found it material that AirTouch had no basis for recognizing revenue associated with the shipments to TM Cell, given that those revenues represented 100% of AirTouch's reported revenues that quarter. As a matter of law, where misstated revenues comprise a

[3] Kaiser's accounting expert, Eric Poer, tries to cast doubt on planned restatement (in which management, the board and the auditors concurred). But he merely concludes that it is "unclear" whether restatement was "appropriate"—not that the restatement was erroneous. To reach this tepid conclusion, Poer has to rely on the counter-factual assumptions that the warehouse contract was not the "term sheet" referenced in TM Cell's purchase order and that the reference to "term sheet" was irrelevant.

significant portion of a company's reported results—here, 100%—the true accounting effect is deemed material to investors. *See, e.g.*, *SEC v. Monterosso*, 768 F. Supp. 2d 1244, 1263 (S.D. Fla. 2011), *aff'd*, 756 F.3d 1326 (11th Cir. 2014) (summary judgment for SEC based on "overstatement of revenue [that was a] staggering" 58% of company's revenues); *SEC v. Chester Holdings, Ltd.*, 41 F. Supp. 2d 505, 522 (D.N.J. 1999) (summary judgment for SEC where assets were overstated by 43 to 100%, and equity overstated by 85-150%; "[a] reasonable investor would unquestionably find it important that [the company's] assets and shareholder equity, and hence its financial condition, were significantly overstated"). That the false revenues derived from the purported largest purchase order in AirTouch's history, for the product considered to be the company's "primary revenue driver," further establish materiality. *See In re MicroStrategy, Inc. Sec. Litig.*, 115 F. Supp. 2d 620, 638 (E.D.Va. 2000) (where "breathtaking overstatement" derived from "among the most important transactions in [the company's] history, it strain[ed] credulity to argue that a reasonable investor ... would have been unaffected by [the] information").[4]

[4] Kaiser has proffered expert testimony that an event study shows minimal stock price reaction to the restatement news, arguing that inflating 100% of the company's quarterly revenue was somehow not material. Putting aside the fact that any reasonable investor would want to know this information, the Division's expert, Dr. David Tabak, will show that an event study cannot be performed on this thinly traded penny stock.

The evidence of Kaiser's scienter is similarly overwhelming. The evidence will show Kaiser's direct involvement the negotiation of the contract between AirTouch and TM Cell—and awareness of its terms—given Kaiser's:

- asking outside counsel to prepare a draft contract for the earlier failed negotiations with Celistics—a contract that expressly stated that AirTouch was not selling any product to Celistics and that would later serve as the template for the contract between AirTouch and TM Cell;
- directing Isaza's negotiations with TM Cell in real-time;
- reviewing drafts of the contract and "purchase order";
- receiving Ego-Aguirre's email attaching the "conditional" purchase order, which stated that the "conditional" purchase order would be voided if the contract was not executed in 24 hours;
- sending the contract to Kanakubo for signature and sending Isaza the signed version for counter-signature by TM Cell; and
- receiving Ego-Aguirre's email attaching both the executed contract and the "purchase order".

Moreover, Kaiser was an experienced CPA. Not only had he directed the terms of the TM Cell contract, but he received several contemporaneous emails discussing the fact that AirTouch still owned the inventory. Therefore, Kaiser

knew full well that no sale had occurred—a matter requiring only a very basic accounting assessment:

> [V]iolations of simple rules are obvious, and an inference of scienter becomes more probable as the violations become more obvious. Put another way, if the GAAP rules and [internal] accounting policies Defendants are alleged to have violated are relatively simple, it is more likely that the Defendants were aware of the violations and consciously or intentionally implemented or supported them, or were reckless in this regard.

MicroStrategy, 115 F. Supp. at 638; *see also In re Baan Co. Sec. Litig*, 103 F. Supp. 2d 1, 21 (D.D.C. 2000) ("[V]iolations involving the premature or inappropriate recognition of revenue suggest a conscious choice to recognize revenue in a manner alleged to be improper, and may therefore support a stronger inference of scienter.").

Kaiser's scienter is further shown by his active concealment of the TM Cell contract. The evidence will show that, due to Kaiser's deception, AirTouch's controller, independent auditors, outside directors, and disclosure counsel had no idea of the warehouse contract's existence. When it was at last revealed, the contract's negating effect on the recognized revenues was obvious to all who received it. "Obscuring financial data from auditors is a strong indication of fraud." *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248, 1273 (N.D Cal. 2000) (scienter adequately pled against where contingent sales transactions resulted in restated revenues; evidence showed "segregation of side letters from

contracts and the deletion of critical computer files") (citing *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 202 (1st Cir. 1999) ("[i]f adequately supported, claims that management deliberately altered company records to hide material information from company auditors could well create strong inferences of scienter")); *see also In re Royal Ahold N.V. Sec. & ERISA Litig.*, 351 F. Supp. 2d 334 (D. Md. 2004) (upholding scienter allegations based on restatement resulting from side letters concealed from auditors); *SEC v. Conaway*, 698 F. Supp. 2d 771 (E.D. Mich. 2010) (upholding jury verdict against CEO for violation of Rule 10b-5 based on, among other things, concealment of liquidity information from board).

The sheer magnitude of the false revenue in the context of AirTouch's financial results—100% of reported revenues—further supports a finding of scienter. *See, e.g.*, *MicroStrategy*, 115 F. Supp. 2d at 636-37 (some GAAP violations "are so significant that they, at the very least, support the inference that conscious fraud or recklessness" existed); *McKesson.*, 126 F. Supp. 2d at 1273 (scienter allegations supported by "widespread and significant inflation" of issuer's revenues); *Marksman Partners, L.P. v. Chantal Pharm. Corp.*, 927 F. Supp. 1297, 1314 (C.D. Cal. 1996) (scienter supported by fact that "allegedly overstated revenues constituted such a significant portion of [the issuer's] total revenues"). The importance of the U250 to the company's third quarter 2012 performance—and its very continuation as a going concern—further suggests that Kaiser's

overstatement of AirTouch's revenues was intentional. *See, e.g.*, *South Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 786 (9th Cir. 2008) (that alleged misrepresentations pertain to "core operations" may support inference of scienter).

Kaiser's certification that the Form 10-Q complied with GAAP and contained no material misstatements or omissions itself supports a finding of scienter, because it establishes that he reviewed the filing for GAAP compliance. *See, e.g.*, *Scott v. ZST Digital Networks, Inc.*, No. CV 11–03531, 2012 WL 538279, at *9 n.2 (C.D. Cal. Feb. 14, 2012) (finding that officers' "signatures certifying the Company's financial statements, along with the critical importance of the financial information being certified, support a finding of scienter"); *In re MF Global Holdings Limited Sec. Litig.*, 982 F. Supp. 2d 277, 319 (S.D.N.Y. 2013) (officers' certifications of false financial statements demonstrated awareness of GAAP requirements for purposes of alleging scienter).

Finally, while the Division need not establish a motive to defraud, Kaiser clearly had it. As the second-highest ranking officer and a holder of AirTouch options, Kaiser sought to increase the company's value by reporting positive news, given the company's undercapitalization and declining stock price. Failure to improve AirTouch's performance would have redounded to Kaiser's detriment—a factor courts consider when assessing motive. *See, e.g.*, *Reese v. Malone*, 747 F.3d 557, 571 (9th Cir. 2014) (complaint adequately alleged officer's motive to conceal

information where it "would portend serious corporate mismanagement, a portent that would be detrimental both to [the issuer and the officer] personally" if the information came to light). Absent AirTouch improving its financial condition, Kaiser's position as chief financial officer and his corporate stockholdings were at stake, given the disclosed risk that the company might not continue as a going concern. This provides a cognizable motive to defraud. *See, e.g., In re Am. Apparel, Inc. S'holder Litig.*, No. CV 10–06352, 2013 WL 174119, at *13 (C.D. Cal. 2013) (crediting as plausible motive to defraud company's desire to avoid going concern disclosure).

2. Kaiser engaged in a scheme to defraud by concealing the TM Cell contract

Rules 10b-5(a) and (c) make it unlawful "to employ any device, scheme, or artifice to defraud" and "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person" in connection with the purchase or sale of any security. "[P]rimary liability under Rule 10b-5(a) and (c) extends to one who (with scienter, and in connection with the purchase or sale of securities) employs *any* manipulative or deceptive device or engages in *any* manipulative or deceptive act ... [and] that standard certainly would encompass the falsification of financial records to misstate a company's performance[.]" *In re John P. Flannery, et al.*, Securities Act Rel. No. 9689, 2014 SEC Lexis 4981, at *39-40 (Dec. 15, 2014) (Comm. op.) (emphasis in original) (holding that

individual violated Rule 10b-5(a) and (c) where he presented misleading information to investors). "To be liable for a scheme to defraud, a defendant must have 'committed a manipulative or deceptive act in furtherance of the scheme.'" *SEC v. Fraser*, No. CV-09-00443, 2010 WL 5776401, at *7 (D. Ariz. Jan. 28, 2010) (quoting *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1997)); *Monterosso*, 756 F.3d at 1329 (affirming summary judgment for SEC under Rule 10b-5(a) and (c) against individual officers who carried out "scheme to generate fictitious revenue"). To establish a violation of Rules 10b-5(a) and (c), the Division must show that Kaiser, in connection with the purchase or sale of a security: (1) engaged in a scheme to defraud or in a course of business that operated as a fraud, (2) with scienter.

The evidence will show that Kaiser, in addition to his false statements, engaged in a scheme to defraud by concealing AirTouch's contract with TM Cell from the other individuals responsible for AirTouch's financial reporting. In addition to his fraudulent misstatements in the Form 10-Q, his purposeful withholding of the contract from the company's controller, outside auditors and outside directors establish deceptive conduct actionable as a scheme to defraud. *See, e.g.*, *SEC v. Familant*, 910 F. Supp. 2d 83, 97 (D.D.C. 2012) (sustaining scheme allegations where officers used sham accounting transactions to conceal deteriorating condition from auditors); *SEC v. Langford*, No. 8:12CV344, 2013

WL 1943484, at *7 (D. Neb. May 9, 2013) (sustaining scheme allegations where officer withheld material information from auditors); *SEC v. Sells*, No. C 11-4941, 2012 WL 3242551, at *6-7 (N.D. Cal. Aug. 10, 2012) (sustaining scheme allegations where officers entered undisclosed side agreements with customers and procured false documentation to facilitate false revenue recognition).

Knowing that anyone with business or accounting experience would understand that TM Cell had not agreed to purchase anything from AirTouch based on the terms of the contract, Kaiser embarked on a sustained effort to ensure no one knew it applied to the purported "purchase order" from TM Cell. To cover up the falsity of the third quarter results, Kaiser buried the contract: deleting it from his email to AirTouch's controller; withholding it from the auditors when asked for all material agreements from the quarter; keeping it from the audit committee chair once the internal investigation commenced; and even instructing other employees to avoid disclosing it to the board. These acts of deception, in furtherance AirTouch's falsely reported revenues, constitute a knowing scheme to defraud.

B. By Falsely Inducing the Tang Family's Investment, Kaiser Violated Securities Act Section 17(a) and Exchange Act Section 10(b) and Rule 10b-5 Thereunder

The second aspect of Kaiser's fraud—duping the Tang family to invest $2 million based on false pretenses—violated both Section 10(b) as well as Section 17(a) of the Securities Act. Section 17(a) makes it unlawful for any person in the

offer or sale of any securities by the use of interstate commerce: (1) to employ any device, scheme, or artifice to defraud; (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. 15 U.S.C. § 77q(a). Section 17(a)(1) requires proof of scienter; Section 17(a)(2) and (3) only require proof of negligence. *See Aaron v. SEC*, 446 U.S. 680, 697 (1980).

By misrepresenting the nature of AirTouch's financial relationship with TM Cell and Telmex to Tang, Kaiser made misstatements actionable under Section 17(a)(2) and Section 10(b) and Rule 10b-5(b) thereunder, as well as engaging in a fraudulent scheme under Section 17(a)(1) and (3) and Section 10(b) and Rule 10b-5(a) and (c) thereunder.[5]

[5] AirTouch's issuance of warrants to the Tang family meets the "in connection with the offer or sale" requirement of Section 17(a), which the Supreme Court has expansively interpreted. *See, e.g., United States v. Naftalin*, 441 U.S. 768, 778 (1979) (Section 17(a) "intended to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading").

1. To induce the Tang family's investment, Kaiser misrepresented the nature of AirTouch's relationships with TM Cell and Telmex

Like Section 10(b), to establish a violation of Section 17(a)(2), the Division must prove, in connection with the offer, purchase, or sale of a security: (1) a material false statement or omission; (2) made with the requisite state of mind—scienter, for Rule 10b-5(b), or negligence, for Section 17(a)(2). *See, e.g., SEC v. Dain Rauscher, Inc.*, 254 F.3d 852, 856 (9th Cir. 2001).[6]

Kaiser, as Tang's primary point of contact for the transaction, made several false representations, including falsely telling Tang that AirTouch had received a substantial purchase order from Telmex. Kaiser provided Tang and his representatives with detailed information about purchase orders AirTouch had received and when payment was expected.[7] This information provided the basis

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[6] For violations of Section 17(a)(2), the Division must also establish receipt of "money or property" by the misstatement. *Id.* That element is easily satisfied because AirTouch received $2 million from the Tang family by Kaiser's misstatements.

[7] That Tang's representatives, rather than Tang himself, may have been the direct recipient of some of Kaiser's misstatements is of no consequence to the Division's claim. The Division is not required to prove reliance. *See, e.g., SEC v. Goble*, 682 F.3d 934, 943 (11th Cir. 2012). Even if it were, such representations would be actionable under the theory of indirect reliance. "[A] claim for fraud may lie even when a plaintiff does not directly rely on a fraudulent representation made by the defendant, if (1) the plaintiff received the information from someone who had received it from the defendant, and (2) the defendant intended the misrepresentation to be conveyed to [the plaintiff]." *Amusement Indus., Inc. v. Stern*, 786 F. Supp. 2d 758, 772-73 (S.D.N.Y. 2011) (citing *Turtur v. Rothschild Registry Int'l, Inc.*, 26 F.3d 304, 310 (2d Cir. 1994)).

for Tang's agreement to recommend the investment to his family. Kanakubo falsely told Tang—via an email Kaiser contemporaneously received—that AirTouch had a 20,000-unit purchase order directly from Telmex, and that TM Cell was merely an intermediary. Kaiser made no effort to correct these misstatements. Given the centrality of AirTouch's sales of the U250 to the abbreviated repayment terms under the loan, there can be little dispute that the status of AirTouch's orders as of mid-October 2012 was material.

The evidence will further show Kaiser's intent, or at a minimum, his recklessness or negligence, in making these representations. As set forth above, Kaiser knew full well the status of the inventory AirTouch had shipped to TM Cell during third quarter 2012—namely, that AirTouch continued to own it, with no guarantee of any payments in sight. Yet Kaiser failed to provide Tang with the contract that governed the largest purchase order he touted to Tang, nor to otherwise reveal that AirTouch had not actually made any large sales to Telmex.

Kaiser also had motive to defraud the Tang family. Desperate to raise capital in fall 2012, Kaiser concealed the contingent nature of the TM Cell purchase order, giving the false impression that AirTouch had completed an actual sale of product. Indeed, without any evidence of sales, Kaiser would not have been able to secure Tang's recommendation that the Tang family should provide the loan. Kaiser's desperation to close the financing to maintain AirTouch as a going

concern evinces motive for purposes of scienter. *See, e.g.*, *Howard*, 228 F.3d at 1063-64 (9th Cir. 2000) (reversing summary judgment, crediting as circumstantial evidence of scienter "red flags" of company's financial condition and desire not to violate liquidity requirements of issuer's loan covenants); *Nguyen v. Radient Pharms. Corp.*, No. CV 11-0406, 2011 WL 5041959, at *8 (C.D. Cal. Oct. 20, 2011) (denying motion to dismiss; allegations that company was "desperate for operating cash" and its "ability to continue operating was dependent upon raising additional capital" reflected circumstantial evidence of motive to mislead).

The fact that Kaiser paid himself unapproved, undisclosed compensation for closing the financing also evidences his motive to defraud, beyond his already dire desire to keep AirTouch afloat. *See, e.g.*, *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 944 (9th Cir. 2003) (bonuses tied to financial performance contributed to inference of scienter); *Szulik v. Tagliaferri*, 966 F. Supp. 2d 339, 364-65 (S.D.N.Y. 2013) (sustaining motive allegations where individual received undisclosed compensation).[8]

[8] *See also SEC v. Wolfson*, 539 F.3d 1249, 1264 (10th Cir. 2008) (affirming summary judgment for the SEC; individuals who received compensation tied to misstatements received "money or property" within the meaning of Section 17(a)(2)).

2. By concealing the TM Cell warehouse contract from Tang both before and after the loan, Kaiser engaged in a scheme to defraud

To establish a violation of Section 17(a)(1), the Division must show that Kaiser engaged in fraudulent conduct, in connection with the purchase or sale of securities, with the requisite mental state: scienter. *Dain Rauscher*, 254 F.3d at 856. To establish a violation of Section 17(a)(3), the Division must show that Kaiser engaged in a transaction, practice or course of business that would "operate as a fraud," in connection with the purchase or sale of securities, either intentionally or negligently. *Flannery*, 2014 SEC Lexis 4981, at *31.

In addition to his misrepresentations to Tang regarding TM Cell and Telmex, Kaiser further engaged in a scheme to defraud. Beginning in or around early 2012, Kaiser engaged in a sustained effort to secure capital from Tang, continuously pitching investment options to him and providing him with updates about AirTouch's business, including regarding TM Cell and Telmex. With the TM Cell "purchase order" in hand, Kaiser seized the moment and began a process—rooted in fraudulent deception—of convincing Tang that AirTouch was selling product to Telmex through TM Cell. When Kaiser finally disclosed to Tang the existence of the agreement governing the terms of AirTouch's relationship with TM Cell in February 2013, he falsely suggested that it had only recently come to his attention.

Scheme liability can arise from "allegations stemming from the same set of facts [as the misrepresentation], as long as the SEC [proves] that the defendant[ ] undertook a deceptive scheme or course of conduct that went beyond the misrepresentations." *SEC v. Stoker*, 873 F. Supp. 2d 605, 614 (S.D.N.Y. 2012) (citation and quotation marks omitted) (denying motion for summary judgment against claim under Section 17(a)(3)); *see also Flannery*, 2014 SEC Lexis 4981, at *29-30, *64 (declining to read subsections of Rule 10b-5 and Section 17(a) as "mutually exclusive;" liability can lie where "as a result of the defendant's negligent conduct, investors receive misleading information about the nature of an investment or an issuer's financial condition"). Kaiser's efforts to conceal the warehouse contract, in furtherance of the material information he withheld from the Tang family, constituted a scheme to defraud under Rule 10b-5(a) and (c), and Section 17(a)(1) and (3).

C. Kaiser Aided and Abetted, and Caused AirTouch's Violations of the Securities Act and the Exchange Act

To prove aiding and abetting liability, the SEC must show: (1) a primary violation; (2) the respondent's substantial assistance in that violation; and (3) the respondent knowing of, or recklessly disregarding, the wrongdoing and his role in furthering it. *See In re Joseph John VanCook*, Exchange Act Rel. No. 61039A, 2009 SEC Lexis 3872, at *55 (Nov. 20, 2009) (Comm. op.); *see also SEC v. e-Smart Techs., Inc.*, No. 11-895, 2014 WL 945816 (D.D.C. Mar. 12, 2014) (quoting

Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000) ("As articulated by the D.C. Circuit, 'three principal elements are required to establish liability for aiding and abetting' a securities violation: '(1) that a principal committed a primary violation; (2) that the aider and abettor provided substantial assistance to the primary violator; and (3) that the aider and abettor had the necessary 'scienter'— *i.e.*, that she rendered such assistance knowingly or recklessly.'")).

The evidence will easily demonstrate AirTouch's primary violations of Section 17(a) and Section 10(b)/Rule 10b-5. AirTouch's third quarter 2012 Form 10-Q contained material misstatements—later withdrawn—with respect to 100% of reported revenues. AirTouch obtained a $2 million investment from the Tang family based on material false statements about its business relationships with TM Cell and Telmex. As CFO, Kaiser's scienter in both sets of misstatements, detailed above, is attributable to AirTouch. *See, e.g.*, *In re Montford & Co.*, Advisers Act Rel. No. 3829, 2014 SEC Lexis 1529, at *57 n.109 (May 2, 2014) (Comm. op.).

That Kaiser substantially assisted in AirTouch's violations is unavoidable. Without his involvement, neither the accounting fraud nor the offering fraud would have been possible. To satisfy the "substantial assistance" element, the Division need only show that Kaiser "'in some sort associated himself with the venture, that he participated in it as something that he wished to bring about, and that he sought by his action to make it succeed.'" *SEC v. Subaye, Inc.*, No. 13 Civ. 3114, 2014

WL 448414, at *9 (S.D.N.Y. Feb. 4, 2014) (citing *SEC v. Apuzzo*, 689 F.3d 204, 206 (2d Cir. 2012)).

As CFO, Kaiser was responsible for the financial statements reported in AirTouch's periodic filings, and falsely certified their accuracy. He was also the primary point of contact for Tang's diligence on the $2 million investment. Kaiser personally precluded AirTouch's controller, its outside auditors, outside counsel, the outside directors of its board, or the Tang family, from finding out about the TM Cell warehouse contract, even after questions about the TM Cell receivable came to light. Kaiser more than provided substantial assistance in these violations: he was the architect of both schemes. *See, e.g.*, *e-Smart Techs.*, 2014 WL 945816, at *13 (sustaining allegations that CEO aided and abetted recordkeeping violations, "by both certifying that the reports were accurate and by 'obstruct[ing] efforts by [issuer's] accountant and auditors to resolve discrepancies' in [issuer's] accounting").

To prove causing liability under Section 21C of the Exchange Act, the SEC need only show that Kaiser "knew or should have known" that his actions would contribute to AirTouch's violations of the securities laws. *See, e.g.*, *KPMG, LLP v. SEC*, 289 F.3d 109, 120 (D.C. Cir. 2002) (noting that "the plain language of Section 21C invokes ... 'classic negligence language'"); *accord In re Russell Ponce*, Exchange Act Rel. No. 43235, 2000 SEC Lexis 1814, at *19 n.25 (Aug. 31,

2000) (Comm. op.), *aff'd*, 345 F.3d 722 (9th Cir. 2003). Given Kaiser's central role in both frauds as set forth above, the evidence will show that he knew or should have known his actions would contribute to AirTouch's primary violations.

IV. LEGAL ARGUMENT – RELIEF

The guiding principle in imposing sanctions against a respondent is the public interest. *See, e.g., In re Vladimir Boris Bugarski et al.*, Exchange Act Rel. No. 66842, 2012 SEC Lexis 1267, at *10-11 (April 20, 2012) (Comm. op.); *In re Joseph P. Doxey*, Initial Decision Rel. No. 598, 2014 SEC Lexis 1668, at *58 (May 15, 2014). In determining whether an administrative sanction is in the public interest, the Commission generally focuses on the factors identified in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979): (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) the respondent's recognition of the wrongful nature of his conduct; and (6) the likelihood that the respondent's occupation will present opportunities for future violations. *Steadman*, 603 F.2d at 1140; *see also In re Gary M. Kornman*, Exchange Act Rel. No. 59403, 2009 SEC Lexis 367, at *22 (Feb. 13, 2009) (applying *Steadman*); *Doxey*, 2014 SEC Lexis 1668, at *58-59 (same); *In re John Thomas Capital Management Group LLC*, Initial Decision Rel. No. 693, 2014 SEC Lexis 4162, at *87 (Oct. 17, 2014) (same).

In addition, the Commission considers whether sanctions will have a deterrent effect. *See In re Schield Mgmt. Co.*, Exchange Act Rel. No. 53201, 58 S.E.C. 1197, 2006 SEC Lexis 195, at *35 (Jan. 31, 2006) (Comm. op.); *In re David F. Bandimere*, Initial Decision Rel. No. 507, 2013 SEC Lexis 3142, at *228-29 (Oct. 8, 2013).

"The appropriate sanction depends on the facts and circumstances of each case." *Schield Mgmt.*, 2006 SEC Lexis, at *35. Thus, the "inquiry into the appropriate sanction to protect the public interest is a flexible one and no one factor is dispositive." *Kornman*, 2009 SEC Lexis 367, at *22; *see also In re Toby G. Scammell*, Advisers Act Rel. No. 3961, 2014 SEC Lexis 4193, at *23 (Oct. 29, 2014) (Comm. op.).

When determining the scope of sanctions, the Commission "consistently [has] held that the appropriateness of the sanctions imposed depends on the facts and circumstances of the particular case and cannot be determined precisely by comparison with action taken in other cases." *In re Kent M. Houston*, Exchange Act Rel. No. 71589, 2014 SEC Lexis 614, at *33, n.60 (Feb. 20, 2014). Therefore, "the Commission is not obligated to make its sanctions uniform," and it is not necessary to compare the sanction under the specific facts and circumstances of a particular case "to those imposed in previous cases." *Kornman v. SEC*, 592 F.3d 173, 188 (D.D.C. 2010); *see also Butz v. Glover Livestock Comm'n Co.*, 411 U.S.

182, 187 (1973) (holding that "[t]he employment of a sanction within the authority of an administrative agency is ... not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases").

The evidence will show that every one of the *Steadman* factors supports the strongest sanctions against Kaiser. As the CFO and highest ranking accountant at AirTouch, Kaiser was the steward of the company's publicly reported financial results. Yet he deceived the stakeholders entrusted with ensuring the accuracy of those disclosures, including the auditors and the board, caused the company to overstate its revenues by 100% for a quarter, and duped a large investor into providing $2 million in financing. This conduct satisfies all of the key *Steadman* factors—it was egregious, was not isolated and involved a high degree of scienter. The evidence will also show that Kaiser has repeatedly failed to acknowledge his wrongdoing, and so any claim that he will not commit future violations cannot be trusted. *See, e.g., In re KPMG Peat Marwick, LLP*, Exchange Act Rel. No. 43862, 54 S.E.C. 1135, 2001 SEC Lexis 98, at *102 (Jan. 19, 2001) (Comm. op.), *recon. denied*, 55 S.E.C. 1, *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002) ("a finding of violations raises a sufficient risk of future violation").

A. Kaiser's Violations Warrant A Cease-and-Desist Order

Section 8A(a) of the Securities Act and Section 21C (a) of the Exchange Act authorize the hearing officer to order Kaiser to cease and desist from committing

violations of the Securities and Exchange Acts. *See* 15 U.S.C. § 77h-1(a); 15 U.S.C. § 78u-3(a).

In assessing whether a cease-and-desist order is appropriate, the Commission considers the *Steadman* factors, as well as "whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings." *KPMG Peat Marwick*, 2001 SEC Lexis 98, at *116. Moreover, while a likelihood of future violations is one of the *Steadman* factors, the showing for that factor is "significantly less than that required for an injunction." *Id.* at *114. Indeed, it is sufficient to show that there was a violation of the securities laws to demonstrate "a sufficient risk of future violation." *Id.* at *102.

As described above, the evidence will demonstrate Kaiser's conscious and repeated disregard of his responsibilities under the federal securities laws. He committed accounting fraud, misstated his company's entire publicly-reported financial results for a fiscal quarter, deceived his staff, the auditors and the board, and defrauded a large investor into providing financing.

B. Kaiser's Misconduct Warrants Severe Monetary Sanctions

1. Kaiser should be ordered to disgorge all ill-gotten gains from his fraud

Sections 8A(e) of the Securities Act and Sections 21B(e) and 21C(e) of the Exchange Act authorize disgorgement in administrative or cease-and-desist proceedings, including reasonable interest. *See* 15 U.S.C. § 77h-1(e); 15 U.S.C. § 78u-2(e), § 78u-3(e).

The goal of disgorgement is two-fold: "'to deprive a wrongdoer of unjust enrichment, and to deter others from violating securities laws by making violations unprofitable.'" *Platforms Wireless*, 617 F.3d at 1096 (quoting *SEC v. First Pac. Bancorp*, 142 F.3d 1186, 1191 (9th Cir. 1998), *cert. denied*, 525 U.S. 1121 (1999)); *see also SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996), *cert. denied*, 522 U.S. 812 (1997). Therefore, "the amount of disgorgement should include all gains flowing from the illegal activities." *In re Donald L. Koch*, Exchange Act Rel. No. 72179, 2014 SEC Lexis 1684, at *90 (May 16, 2014) (Comm. op.) (citing *SEC v. JT Wallenbrock & Assoc.*, 440 F.3d 1109, 1113-14 (9th Cir. 2006)).

When seeking disgorgement, the Division only needs to present evidence of a "reasonable approximation" of the ill-gotten gains. *Id.*; *see also First Jersey*, 101 F.3d at 1474. Once the Division has made that showing, the burden shifts to the respondent to "demonstrate that the disgorgement figure was not a reasonable

approximation," and any "risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty." *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231-32 (D.C. Cir. 1989); *see also Koch*, 2014 SEC Lexis 1684, at *90-91; *In re S.W. Hatfield, CPA*, Exchange Act Release No. 73763, 2014 SEC Lexis 4691, at *43 (Dec. 5, 2014) (Comm. op.).

The record could support a significant joint and several disgorgement award against Kaiser for his fraud in duping the Tang family to loan AirTouch $2 million. An officer of a company can be held jointly and severally liable for the ill-gotten proceeds of the company. *See In re Gordon B. Pierce*, Securities Act Rel. No. 9555, 2014 SEC Lexis 839, at *91 (Comm. op.) (cases cited therein, for joint and several liability disgorgement award); *see also JT Wallenbrock*, 440 F.3d at 1117 ("[W]here two or more individuals or entities collaborate or have a close relationship in engaging in the violations of the securities laws, they [may be] held jointly and severally liable for the disgorgement of illegally obtained proceeds.") (citation omitted). This is true even if the officer did not personally receive any that money. As the Second Circuit recently explained, "limiting disgorgement amounts to the direct pecuniary benefit enjoyed by the wrongdoer would run contrary to the equitable principle that the wrongdoer should bear the risk of any uncertainty affecting the amount of the remedy" *SEC v. Contorinis*, 743 F.3d 296, 306 (2d Cir. 2014); *see also Pierce*, 2014 SEC Lexis 839, at *91.

Kaiser, as CFO, was intimately involved in defrauding the Tang family into providing AirTouch with $2 million of desperately needed capital. The evidence will show that Kaiser was the primary contact for the Tang family in arranging the loan, yet never disclosed the fact that TM Cell was not actually buying product from AirTouch. As a direct result of his fraud, the Tang family lost $2 million. Kaiser's central role would support a joint and several disgorgement award against him for that full amount. *See First Pac. Bancorp*, 142 F.3d at 1191 (affirming joint and several disgorgement award against CEO and company for $688,000 in proceeds fraudulently raised in public offering, since CEO "played a principal role" in fraud and "clearly enjoyed a close relationship" with company); *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 455-456 (3d Cir. 1997) (similar); *Platforms Wireless*, 617 F.3d at 1098 (similar).

Kaiser could also be ordered to disgorge the money he personally received from his fraud. The evidence will show that on October 19, 2012—the very same day the $2 million loan hit AirTouch's bank account—Kaiser personally authorized a bonus payment of $15,000 for himself, never approved by the board's compensation committee. Without that loan, the company did not have sufficient funds to meets its operating and payroll expenses; the $2 million loan was consumed in the span of just four weeks. During that time, Kaiser received more than $10,000 in salary—which he could not have received but for the loan. All of

this is disgorgeable as ill-gotten gains. *See, e.g., SEC v. Razmilovic*, 738 F.3d 14, 32-33 (2d Cir. 2013) (affirming disgorgement award requiring CEO to return bonuses and other payments received during accounting fraud); *SEC v. Koenig*, 532 F. Supp. 2d 987, 992-95 (N.D. Ill. 2007) (CFO ordered to disgorge bonuses plus prejudgment interest for years in which company engaged in accounting fraud), *aff'd in part and remanded in part*, 557 F.3d 736 (7th Cir. 2009) (remanding with respect to the calculation of defendant's bonuses under proper accounting).[9]

2. Kaiser should pay third-tier civil penalties

Sections 8A(g) of the Securities Act and Sections 21B(e) and 21C(e) of the Exchange Act authorize the Commission to seek disgorgement in administrative or cease-and-desist proceedings, including reasonable interest. *See* 15 U.S.C. § 77h-1(g); 15 U.S.C. § 78u-2(a).

Penalties should be imposed when they serve the public interest, and are meant to deter future violators. *See, e.g., In re Raymond James Fin. Servs., Inc., et al.*, Initial Decision Rel. No. 296, 2005 SEC Lexis 2368, at *197 (Sept. 15, 2005). The statute provides several factors to consider: (1) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory

[9] The Division will also seek prejudgment interest on the disgorgement award. *See, e.g., In re Terence Michael Coxon*, Exchange Act Rel. No. 48385, 56 S.E.C. 934, 2003 SEC Lexis 3162 (Aug. 21, 2003) (Comm. op.), *aff'd*, 137 F. App'x 975 (9th Cir. 2005).

requirement; (2) the resulting harm to other persons; (3) any unjust enrichment and prior restitution; (4) the respondent's prior regulatory record; (5) the need to deter the respondent and other persons; and (6) such other matters as justice may require. *See* 15 U.S.C. § 78u-2(c). "'Not all factors may be relevant in a given case, and the factors need not all carry equal weight.'" *Bandimere*, 2013 SEC Lexis 3142, at *249-50 (citations and quotations omitted).

As for the amount of the penalty, "a three-tiered statutory framework provides the maximum civil money penalty that may be imposed for each violation if found in the public interest." *Doxey*, 2014 SEC Lexis 1668 at *7-68. The highest level of penalties, a third-tier penalty, is $150,000 for each violation committed by a natural person. *See* 17 C.F.R. § 201.1004 (2011), Subpart E, Table IV. These penalties are justified if the respondent is found to have engaged in fraud, deceit, or deliberate or reckless disregard of a regulatory requirement, and if that fraud "resulted in substantial losses or created a significant risk of substantial losses to other persons," or "substantial pecuniary gain" to the respondent. 15 U.S.C. § 77h-1(g)(2)(C), 15 U.S.C. § 78u-2(b)(3).

While the statutory tier system sets forth the maximum penalty, it is up to the hearing officer to determine the amount of the penalty to be imposed within the tier. *See In re David Mura*, Initial Decision Rel. No. 491, 2013 SEC Lexis 1700, at *40 (June 14, 2013) (citing *SEC v. Murray*, No. OS-CV-4643 (MKB), 2013 WL

839840, at *3 (E.D.N.Y. Mar. 6, 2013)). In making that assessment, courts have considered the following factors established in *SEC v. Lybrand*:

> (1) the egregiousness of the violations at issue, (2) defendants' scienter, (3) the repeated nature of the violations, (4) defendants' failure to admit to their wrongdoing; (5) whether defendants' conduct created substantial losses or the risk of substantial losses to other persons; (6) defendants' lack of cooperation and honesty with authorities, if any; and (7) whether the penalty that would otherwise be appropriate should be reduced due to defendants' demonstrated current and future financial condition.

281 F. Supp. 2d 726, 730 (S.D.N.Y. 2003), *aff'd on other grounds*, 425 F.3d 143 (2d Cir. 2005); *see also Bandimere*, 2013 SEC Lexis 3142, at *251-52. Although these factors provide guidance, "the civil penalty framework is of a 'discretionary nature' and each case 'has its own particular facts and circumstances which determine the appropriate penalty to be imposed.'" *Murray*, 2013 WL 839840, at *3 (quoting *SEC v. Opulentica, LLC*, 479 F. Supp. 2d 319, 331 (S.D.N.Y. 2007)).

Moreover, the size of a civil penalty is "not limited to the amount of profits derived from the violation." *In re Ronald S. Bloomfield*, Exchange Act Rel. No. 71632, 2014 SEC Lexis 698, at *91 (Feb. 27, 2014) (Comm. op.). Thus, the civil penalty imposed against Kaiser can far exceed any personal gain he had, since civil penalties can be imposed "without regard to defendants' pecuniary gain." *Id.* (finding that penalty for one respondent that was 27 times larger than his pecuniary gain was proper).

Here, the evidence will show that third-tier civil penalties are more than justified. Kaiser's conduct involved fraud and a deliberate or reckless disregard of the federal securities laws. His fraud also involved two distinct violations—the accounting fraud and the offering fraud. These frauds harmed the Tangs and all the other shareholders of the now-defunct company. Finally, a large penalty is needed to deter any CFOs from committing the kind of fraud that Kaiser carried out.[10]

C. Kaiser Should Be Barred from Acting as an Officer or Director

The hearing officer has the power to impose officer and director bars under Section 8A(f) of the Securities Act and Section 21C(f) of the Exchange Act. *See* 15 U.S.C. § 77h-1(f); 15 U.S.C. § 78u-3(f).

The goal of such bar is to prevent a respondent from acting as an officer or director of a public company if his "conduct demonstrates unfitness to serve" in that role. 15 U.S.C. § 77h-1(f), 15 U.S.C. § 78u-3(f). Significantly, the Sarbanes-

[10] Any claim by Kaiser that he cannot afford any monetary award does not preclude the imposition of a large monetary sanction. "[N]othing in the securities laws expressly prohibits a court from imposing penalties or disgorgement liability in excess of a violator's ability to pay." *SEC v. Warren*, 534 F.3d 1368, 1370 (11th Cir. 2008). A respondent's ability to pay a penalty is "[a]t most" just one factor to be considered. *Id.*; *accord In re Philip A. Lehman*, Exchange Act Rel. No. 54660, 2006 SEC Lexis 2489, at *11 (Oct. 27, 2006) (on *de novo* review, Commission rejecting respondent's claimed inability to pay and imposing full penalty given the egregiousness of the violations and the for deterrence effect). Otherwise, courts, by taking into account a fraudster's ability to pay, "would allow con artists to escape disgorgement liability by spending their ill-gotten gains—an absurd result." *Warren*, 534 F.3d at 1370 n.2.

Oxley Act of 2002 reduced the standard for a bar from requiring a showing of "substantial unfitness" to only "unfitness." In making that change, "Congress's intent was to lower the threshold of misconduct for which courts may impose director and officer bans." *SEC v. Bankosky*, 716 F.3d 45, 48 (2d Cir. 2013).

Before this change, courts and hearing officers generally relied on the factors set forth in *SEC v. Patel*, 61 F.3d 137, 141 (2d Cir. 1995) to assess whether a bar was justified. *See In re John Thomas Capital Mgmt. Group LLC*, Initial Decision Rel. No. 693, 2014 SEC Lexis 4162, at *98-99 (Oct. 17, 2014) (applying *Patel* factors). Because the *Patel* factors were developed under the "earlier version" of the statute they are therefore arguably too stringent. Courts have subsequently referred to the "following non-exhaustive list of factors in making a post-Sarbanes-Oxley 'unfitness' determination":

> (1) the nature and complexity of the scheme; (2) the defendant's role in the scheme; (3) the use of corporate resources in executing the scheme; (4) the defendant's financial gain (or loss avoidance) from the scheme; (5) the loss to investors and others as a result of the scheme; (6) whether the scheme represents an isolated occurrence or a pattern of misconduct; (7) the defendant's use of stealth and concealment; (8) the defendant's history of business and related misconduct; and (9) the defendant's acknowledgement of wrongdoing and the credibility of his contrition.

SEC v. Levine, 517 F. Supp. 2d 121, 145 (D.D.C. 2007); *see also SEC v. Bankosky*, 716 F.3d 45, 49 (2d Cir. 2013) (noting these factors, but recognizing that most courts still apply the *Patel* factors).

The evidence should support a permanent officer and director bar against Kaiser. Kaiser had a central role in the scheme—he was the CFO who oversaw the accounting fraud, and he was the company's point of contact who duped the Tang family into making the loan. The conduct was egregious for a public company CFO, and the evidence will show Kaiser had a high level of scienter in carrying out the fraud. His conduct was also not isolated. His fraud was carried out over the course of several months, and involved two separate frauds. These facts, which will be proven at trial, will all weigh heavily in favor of a permanent officer and director bar. *See First Pac. Bancorp*, 142 F.3d at 1193-94 (affirming permanent officer and director bar for CEO who committed offering fraud); *SEC v. Subaye, Inc.*, No. 13 Civ. 3114 (PKC), 2014 WL 4652578, at *2-3 (S.D.N.Y. Sept. 18, 2014) (imposing permanent officer and director bar for CFO who committed accounting fraud); *John Thomas Capital*, 2014 SEC Lexis 4162, at *99 (imposing permanent officer and director bar for founder and adviser of investment funds); *Doxey*, 2014 SEC Lexis 1668 at *76-78 (imposing permanent officer and director bar for CEO who made false disclosures in public filings).

D. A Rule 102(e) Practice Bar Is Also Justified

Kaiser is a licensed CPA who has appeared and practiced before the Commission as a CFO of a public company. The evidence will support a lifetime

bar prohibiting him from practicing before the Commission under Rule 102(e)(1)(iii) of the Rules of Practice.

Rule 102(e) "is the primary tool available to the Commission to protect the integrity of its administrative processes," *In re Steven Altman, Esq.*, Exchange Act Rel. No. 63306, 2010 SEC Lexis 3762, at *37 (Nov. 10, 2010) (Comm. op.), and is also used to ensure "the integrity of the financial reporting process." *Marrie v. SEC*, 374 F.3d 1196, 1200 (D.C. Cir. 2004). Rule 102(e)(1)(iii) allows the Commission to exclude any professionals "who are found to have violated the federal securities laws or rules and regulations thereunder." *Altman*, 2010 SEC Lexis 3762, at *37; 17 C.F.R. § 201.102(e)(1)(iii). Thus, if Kaiser is found liable for willfully violating the antifraud provisions of the securities laws, then his privilege of appearing before the Commission should clearly be revoked under the rule. *See* 17 C.F.R. § 201.102(e)(1)(iii); *Russell Ponce*, 2000 SEC Lexis 1814, at *36-37.

V. CONCLUSION

The Division respectfully submits that the evidence at the hearing will establish that Kaiser is liable and thus should face severe sanctions, in the form and amounts to be specified by the Division in its post-hearing briefing.

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Respectfully submitted,

DIVISION OF ENFORCEMENT SECURITIES AND EXCHANGE COMMISSION

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