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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File Nos. 3-16311

In the Matter of
TIMOTHY S. DEMBSKI,
Respondent.

DIVISION OF ENFORCEMENT'S BRIEF IN RESPONSE TO RESPONDENT TIMOTHY DEMBSKI'S APPEAL OF THE ADMINISTRATIVE LAW JUDGE'S INITIAL DECISION

Dated: April 22, 2016

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The Division of Enforcement ("Division") respectfully submits this brief in response to Respondent Timothy S. Dembski's Appeal of the Administrative Law Judge's Initial Decision.

PRELIMINARY STATEMENT

As the Administrative Law Judge ("ALJ") correctly found, Timothy Dembski defrauded his advisory and tax clients by lying to them repeatedly, both orally and in writing, in order to attract millions of dollars of investments into Prestige Wealth Management Fund, LP (the "Prestige Fund" or "Fund"), the start-up hedge fund he created with his friend Scott Stephan.

In a one-week hearing that took place from May 11 to May 18, 2015 ("Hearing"), eight of Dembski's clients, most of whom were elderly and financially unsophisticated, detailed many false statements Dembski communicated to them in soliciting their investments in the Prestige Fund. The ALJ was correct to find that "Dembski made the following false statements about the Fund to his clients: (1) Dembski would play an active role in running, managing, monitoring, and overseeing the Fund; (2) Dembski invested his family's money in the Fund; (3) a big bank expressed interest in investing millions of dollars in the Fund or its trading formula; (4) the Fund was insured by the FDIC; (5) the Fund's trading formula was Dembski's idea; (6) Dembski was engaged in efforts to patent the Fund's algorithm; (7) the Fund had little or no risk, and would gain 20% in value annually; and (8) investors could withdraw their money at any time." *Reliance Financial Advisors, LLC, et al.*, Rel. No. 941, 2016 WL 123127, at *17 (Jan. 11, 2016) ("Initial Decision" or "ID"). Dembski's lies had significant consequences, as after hearing his misrepresentations, Dembski's clients invested over $4 million in the Fund from 2011 to 2012, approximately 80% of which was lost by the time the Fund closed its doors.

Dembski does not contest that each of these highly material statements was false, or even that he knew the statements were false. Dembski's only defense is to deny that he ever uttered

these misrepresentations. But as the ALJ observed, Dembski's denials are at odds with the testimony of "***all*** of his testifying client-investors." ID at *2 (Jan. 11, 2016) (emphasis added).) The ALJ further found, properly, that Dembski's clients were more credible than Dembski. *Id.*

Dembski's defense concerning written misrepresentations in the Private Placement Memorandum ("PPM") he utilized in soliciting investments is equally unavailing. That PPM falsely described Stephan, a former automobile repo man with no experience managing money, as having "worked in the financial services industry for over 14 years" and having "co-managed a portfolio of over $500 million." These lies were particularly important given Stephan's role as the Fund's portfolio manager with exclusive authority to invest Fund assets. Dembski knew the PPM's description of Stephan's experience was false, but insists that he disseminated the PPM pursuant to the advice, and even at the "urging," of Fund counsel. As the ALJ correctly found, however, Dembski "failed to establish any of the four elements of [an advice-of-counsel] defense." ID at *19. Dembski's own lawyers testified that Dembski never asked for, let alone received, any legal advice concerning the misrepresentations about Stephan contained in the PPM.

Citing the overwhelming evidence of Dembski's liability, the ALJ found Dembski liable for violating the antifraud provisions of the Securities Act of 1933 ("Securities Act"), Securities Exchange Act of 1934 ("Exchange Act") and Investment Advisers Act of 1940 ("Advisers Act"). To prevent Dembski from profiting from his misconduct and to vindicate the public interest, the ALJ issued an order barring Dembski from the securities industry and requiring him to cease and desist violations of those laws, to disgorge the $363,784.66 in ill-gotten gains and pay prejudgment interest thereon, and to pay a civil monetary penalty of $250,000. In light of the egregiousness of Dembski's fraud, the number of victims and harm done to them, Dembski's utter failure to take any responsibility for his actions, and his intent to remain in the securities industry where he would

put additional investors at risk, the ALJ's order was appropriate and should be affirmed.

STATEMENT OF FACTS

I. Significant Entities and Individuals

Timothy Dembski is [redacted] years old and, at the time of the Hearing, held Series 7, 63 and 66 securities licenses. (Tr. 501:2-3; 607:7-14; Ex. 60.)[1] Dembski co-owned Prestige Wealth Management LLC ("Prestige LLC"), with Scott Stephan, the General Partner for the Prestige Fund. (Dembski Answer ¶ 2; Div. Ex. 90 (PPM) at 7.)

Scott Stephan, age [redacted], co-owned Prestige LLC with Dembski. (Dembski Answer at 14.) From approximately August 2009 through March 2011, Stephan was a registered representative associated with a registered broker-dealer. (Ex. 67 at 3.)

Prestige Wealth Management Fund LP was a hedge fund created by Dembski and Stephan as a pooled investment vehicle. (Tr. 67:18-23; Ex. 90 at 54.)

Prestige LLC was the Fund's general partner. (Tr. 81:11-23; Ex. 90 at 7.) Dembski owned 50% of Prestige LLC. (Tr. 636:15—637:3; Ex. 88 at 5.)

Reliance Financial Advisors, LLC ("Reliance Financial Advisors") was, at all times relevant herein, an investment advisor registered with the Securities and Exchange Commission. (Tr. 446:13-24; Ex. 55 at 1.) Dembski and Walter Grenda co-owned Reliance Financial Advisors. (Tr. 447:15-22; Ex. 55 at 19-20.)

II. Prestige Fund Background

When Stephan and Dembski founded the Prestige Fund, they divided responsibilities. Stephan was to manage the Fund's portfolio, while Dembski, along with Grenda, would provide

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[1] Citations to "Tr. __" refer to the Hearing trial transcript in this matter. Citations to "Ex. __" are to exhibits offered by the Division and admitted at the Hearing.

access to clients and their money.[2] Dembski acknowledges that before creating the Fund, he "really didn't know what a hedge fund was." (Tr. 521:19—522:8; *see also* 640:13—641:13.) But he had relationships with clients, and the Fund's business plan included targeting Dembski's clients at Reliance Financial Advisors as potential investors. (Tr. 105:7-17.)

In the brief life of the Prestige Fund, 43 people invested a total of $12,528,145 in the Fund. (Ex. 87; Tr. 11:4-14.) Those investors purchased "[l]imited partnership interests in the Fund" (Ex. 90 at 9) through sales involving the use of means and instrumentalities of interstate commerce and the mails. (Ex. 99 at iv; Tr. 339:22—340:2; Ex. 72.)

Dembski Did Not Play Any Meaningful Role in Running the Prestige Fund.

Notwithstanding his lack of trading experience, Stephan had "exclusive responsibility to manage the fund and make its investment decisions." (Tr. 487:13-16.) Dembski was not permitted to play any meaningful role in the daily operation of the Fund or even to ask Stephan "for information as to the investment performance of Prestige." (Tr. 631:25-632:8; *see also* 783:15-21.) Setting up the Fund this way allowed Dembski to earn performance fees he could not collect if he played a more active role managing the Fund. (Tr. 80:4-21; 780:24—782:3; Ex. 10 at 1.)

The Prestige Fund's Trading Plans

Stephan devised the trading formula the Fund initially employed. (Tr. 67:24—68:2; 660:4-12.) Stephan's idea was to trade at specific times each day, taking positions based on the momentum of certain stocks' share prices at designated times. (Tr. 68:12—69:10-23.)

Stephan employed Anthony Cascino, an engineer Stephan found on the internet, to assist

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[2] As set forth in the Commission's July 31, 2015 Order, Grenda consented to the entry of an order imposing sanctions including disgorgement, civil penalties and an industry bar (with the right to apply for reentry after three years) addressing, among other things, his fraudulent sales of Prestige Fund investments. *See* https://www.sec.gov/litigation/admin/2015/33-9872.pdf.

him in translating his idea into a "mathematical equation in computer language." (Tr. 101:3-6.) Cascino's "only role was to translate the strategy [Stephan] gave him into some computer code" to allow Stephan to trade in an automated fashion. (Tr. 101:13-24.) Cascino did not help Stephan come up with the trading strategy or have input into the stocks Stephan chose, and Stephan never told Dembski otherwise. (Tr. 101:25—102:25.)

Stephan claims to have "back-test[ed]" his trading formula, though he never performed tests approximating real-world circumstances—*i.e.*, he did not run tests filling any actual trades or orders—which left Stephan concerned about how orders would get filled at the correct price when the Fund began trading. (Tr. 70:11—72:15.) Stephan told Dembski about the concerns he had with the limits of back-testing. (Tr. 72:16—73:14.)

The Fund Quickly Encountered Difficulties after Commencing Trading.

The Fund started trading in approximately March 2011 using the trading formula, or algorithm, Stephan created. (Tr. 111:15-21.) Dembski initially understood that all trading would be driven by the algorithm with Stephan's day-to-day role being limited to simply pressing a button—*i.e.*, "[t]urning [the computer algorithm] on and turning it off and monitoring the actual fund." (Tr. 704:16-20.) Dembski testified that one reason he was comfortable granting Stephan exclusive responsibility for trading was that Stephan could rely on the computer program. (Tr. 704:21—705:6.) Indeed, Dembski claimed to tell an investor that Stephan's role would be simply "turning on or turning off the fund algorithm in the computer traded program on a daily basis." (Tr. 585:8—586:16.)

When the Fund began trading, Stephan's formula did not work as planned, and Stephan informed Dembski of the Fund's trading problems, explaining he wasn't "able to fill orders when [he] wanted pursuant to the algorithm and trading formula" and had to "make some tweaks to the

fund because of the prices that were going in and out." (Tr. 112:2—114:4.) Stephan tried to fix the algorithm, but while he did so, starting in or around August 2011, Stephan traded "manually," a fact he shared with Dembski. (Tr. 114:12-22.) Dembski never expressed concerns to Stephan about trading manually and never asked Stephan if he stopped doing so. (Tr. 116:4-9.) When Stephan's attempts to fix the algorithm failed, he continued to trade manually and never told Dembski otherwise. (Tr. 114:23—116:3.)

Grenda redeemed his clients' investments from the Fund in October 2012. (Tr. 116:10-15.) Consequently, Grenda's clients roughly broke even on their investments in the Fund. (Tr. 117:10-18.) With only Dembski's clients' money in the Fund, Stephan traded stocks and options. (Tr. 116:21-24.) In December 2012, Stephan lost approximately $3 million—more than 80 percent of the money Dembski's clients had in the Fund at that time—mostly through options trading. (Tr. 116:25—117:6; Ex. 140 ¶ 5.)

III. Dembski Misrepresented Material Facts in Oral Communications with His Clients.

Dembski's clients testified in detail about Dembski's misrepresentations.

A. John Skop

John Skop, age ■[3] has lived near Buffalo, New York, since 1972. (Tr. 167:9-19.) Skop started working with Dembski around February 2001 after Skop received a $352,000 insurance payment following his son's death in military service. (Tr. 168:20—169:11.) Skop told Dembski: "[M]y son died for this money . . . I don't want any high risk investments." (Tr. 169:20—170:3.)

Dembski introduced Skop to the Fund in 2011 after serving as Skop's "money manager" for at least a decade. (Tr. 167:23—168:5; 186:18—187:2.) Skop invested $250,000, the amount Dembski told him was the minimum one could invest, which represented "[a] little over half" of

[3] Investors' ages are listed as of the time of the Hearing.

what Skop had saved. (Tr. 171:15—172:2; 172:17-23.) To liquidate $250,000, Skop incurred a $16,000 penalty to cash in an annuity, a charge about which Dembski was aware. (Tr. 172:3-14.)

Dembski told Skop the following about the Fund:

a. Dembski was "putting every dollar he can into it to pay for his kids' college education down the road because he believes in it that strongly." (Tr. 174:2-11; *see also* 200:3-9.) Skop explained: "[T]his was the first time in 12 years that [Dembski] recommended a stock because he is getting into it. He never did that at any other time" (Tr. 202:9-16);

b. Because Dembski had his investment in the Fund, he was "going to look at it daily to make sure things were performing" (Tr. 174:16-22);

c. The software and Fund were "so good that New York investment bankers were willing to buy it," which gave Skop "encouragement that this was a good fund [because] other people saw it as something good also" (Tr. 175:2-20);

d. Dembski and Stephan ran it as a "skeleton investment" for a year and a half and the returns "were great" (Tr. 173:16-25); and

e. The Fund was a "low risk" investment. (Tr. 187:24—188:12.)

Prior to investing in the Fund, Skop expressed to Dembski a concern that the PPM was not favorable to investors. Specifically, Skop told Dembski that "there is nothing positive there for the investor. Everything in there is warnings what can happen." (Tr. 175:21—176:7; *see also* 193:7-15.) Dembski told him to "disregard that. It's [a] boilerplate contract for investments in [a] hedge fund. Believe me . . . I wouldn't be investing my money if I believed that too." (Tr. 176:8-12; *see also* 190:4—191:11; 193:18—194:3.)

B. Thomas Krajewski

Thomas Krajewski, ag[redacted] has lived in the Buffalo area his entire life and started working with Dembski in 2004. (Tr. 205:3-10.) Dembski served as Krajewski's financial adviser. (Tr. 204:24—205:2.) Krajewski and his wife told Dembski they were "interested in maintaining, preserving our money, and likewise earning some money on it." (Tr. 205:11-19.) Krajewski

invested $250,000 in the Fund—the minimum amount he understood someone could invest—representing almost his entire IRA. (Tr. 207:6—208:4.)

Dembski told Krajewski the following about the Fund:

a. It was an idea Dembski came up with on a visit to Las Vegas when "he noticed something about what was going on at the roulette table that somehow would apply to financial transactions, investing, and he got an associate that would take and implement this idea with a computer program and see if it would work" (Tr. 206:10—207:3);

b. It "was supposed to make 20 percent" (Tr. 211:24—212:10; 216:6-15; Ex. 75);

c. Stephan "had many years in the financial industry, and that he was the manager of . . . a half billion dollar portfolio at some time," which Krajewski later saw in the PPM (Tr. 209:7—210:2); and

d. Dembski would have "oversight," responsibilities, which was important to Krajewski because he had never met Stephan before discussing the Fund. (Tr. 208:10—209:6; 221:9-13.)

Dembski never told Krajewski that the algorithm did not work and that the Fund stopped trading using the computerized system. (Tr. 213:12-15.) Krajewski would have wanted to know if Stephan did not have experience managing a portfolio of millions of dollars because he would not "leave [his hard earned money] for a stranger to have complete control over it." (Tr. 210:23—211:12.) Krajewski was "overwhelmed" by the PPM, but when he told Dembski this, Dembski dismissed the PPM language as "legalese." (Tr. 210:6-22; *see also* 223:9-16.)

C. Renee Broderick

Renee Broderick, age █ first met Dembski in 2003 through her first husband and his father, who were long-term clients of Dembski. (Tr. 279:12—280:12.) Broderick first started working with Dembski alone in January 2011 after her first husband died. (Tr. 280:6-12.)

After her husband died, the "first phone call" Broderick made was to Dembski because she wanted to ensure her money was invested to provide for her and her son. (Tr. 291:22—292:13.)

Broderick received $250,000 in life insurance benefits (Tr. 281:6-11), and she told Dembski she wanted to be "conservative" with that money, that "with [her] new status of being a single mom and down to one income, [she] wasn't comfortable being risky. So [she] wanted to be secure for [her] future, [her] son's future." (Tr. 281:16-23; *see also* Tr. 290:18—291:9.)

Dembski introduced Broderick to the Fund (Tr. 279:8-11), and told her the minimum investment was $250,000. (Tr. 280:23—281:3.) Dembski also told Broderick the following:

a. The Fund was "high rewards, low risk . . . . He told me that based on where I was at that point in my life that I couldn't lose with it" (Tr. 280:16-22; *see also* Tr. 282:6-11);

b. The Fund and algorithm were Dembski's idea (Tr. 283:7-13);

c. Dembski "would be managing it daily. He would watch it daily," which was important to her because she "trusted him . . . . He helped me when my husband passed away with all of the accounts . . . so I trusted everything he told me" (Tr. 284:9-23; *see also* 297:13-25);

d. The way the computer algorithm worked, Broderick couldn't lose any more than one percent per day (Tr. 282:12—283:6), though Dembski never explained to Broderick that the Fund stopped using the computer to trade in Summer 2011 (Tr. 286:14-18);

e. Dembski was trying to get the algorithm patented and met with "lawyers on Wall Street" to do so (Tr. 284:24—285:11);

f. Dembski invested his own money in the Fund because "it was such a for sure thing" (Tr. 305:16-22); and

g. Dembski could pull Broderick's money out at any time (Dembski did not mention the Fund's 90-day waiting period for withdrawals, as set forth in the PPM, which Broderick explained would have been important for her to know). (Tr. 283:14—284:8.)

Dembski never mentioned Stephan to Broderick or explained that someone other than Dembski would have exclusive authority to make investment decisions, which Broderick would have wanted to know when making her own investment decision. (Tr. 285:12—286:5.) And Broderick did not receive documents about the Fund from Dembski until the day she handed over

her $250,000 check to invest in the Fund. (Tr. 299:13-16.) After Broderick realized the Fund was losing money she tried to redeem her investment, but Dembski kept giving her the "run-around"; it took three months to get her money (less $40,000) out of the Fund. (Tr. 287:16—288:8; Ex. 127 at 6.)

D. Anna Barrett

Anna Barrett, age █ has lived in Buffalo all of her life. Barrett currently works part-time teaching the deaf after doing so full-time until she retired in 2005. (Tr. 308:3-13.)

Dembski started doing Barrett's taxes in 1997 and became her financial adviser several years later. (Tr. 308:23—309:11.) Barrett entrusted her money to Dembski after a previous financial adviser put her in an investment she deemed too "high risk." (Tr. 309:15-24.) Barrett left that adviser because she "always wanted to invest very conservatively," and Barrett told Dembski that she "wanted to be conservative and not be in any risky funds." (Tr. 309:15—310:13.) Barrett told Dembski that her primary investment goal was preservation of capital. (Tr. 310:14-18.)

When Dembski introduced the Prestige Fund to Barrett, he assured her that he "developed [the Fund] and that he would monitor [it], . . . he could monitor it daily so if it started to have losses, he could have me out right away, and that he thought it would . . . make a lot of money for me." (Tr. 310:19—311:6; *see also* 318:8-22.) That was important to Barrett. (Tr. 312:6-12.) Dembski also told Barrett that investing in the Fund "would make [her] granddaughter very rich." (Tr. 318:16-18.) Barrett "never would have invested in [the Fund] if [she] had known" it was a high risk investment. (Tr. 324:6-14.) Dembski did not provide Barrett with any paperwork concerning the Fund (including the PPM) before she invested. (Tr. 320:16-24; 323:13-20.)

After Dembski informed Barrett that most of her investment in the Fund had been lost, Dembski explained that "he couldn't monitor the fund because he was an investor in the fund ...

and it would be a conflict of interest for him to know what was happening in the fund." (Tr. 312:13-21.) Barrett was "surprised" when Dembski told her that because he previously "told [her] that he would be able to monitor the fund daily," which addressed her "concern about losing money." (Tr. 313:19—314:4.) Dembski told Barrett her money was lost because "his friend was doing the investments and he was putting the money in crazy things…" (Tr. 312:25—313:9.)

Barrett would have wanted to know if Stephan had exclusive authority to trade and run the Fund because she "had never heard of him and [she] invested in this fund because [she] had a long-term relationship with [Dembski] and [she] trusted him." (Tr. 314:15—315:2.) Barrett invested $225,000 in the Fund and lost all but approximately $17,000. (Tr. 324:24—325:4.) It was not until her money was lost that Barrett first heard of Stephan. (Tr. 313:10-17.)

E. Richard and Vicki Blaszkiewicz

Richard Blaszkiewicz, age [redacted] has lived in or around Holland, New York for his entire life. Mr. Blaszkiewicz's wife, Vicki Blaszkiewicz, is [redacted] old and has a high school education. The Blaszkiewiczes first met Dembski approximately 16 or 17 years ago at a financial seminar. (Tr. 352:11-17.) Shortly thereafter, Dembski became Mrs. Blaszkiewicz's financial adviser. (Tr. 352:18—353:3.) Dembski became Mr. Blaszkiewicz's financial adviser when Mr. Blaszkiewicz retired in 2011 from his job as a machinist at Moog, Inc. (Tr. 326:23—328:6.)

Dembski introduced the Blaszkiewiczes to the Fund around the time of Mr. Blaszkiewicz's retirement. (Tr. 327:13-17; 328:15-18.) Mr. Blaszkiewicz told Dembski that because he was retiring, he "needed a secure investment program . . . . We couldn't afford to lose a lot of money. We needed the money to live on the rest of our lives." (Tr. 329:7-23; *see also* 339:6-17.)

Mr. Blaszkiewicz invested $250,000 in the Fund (Tr. 329:24—330:3), after hearing Dembski make the following representations:

a. The Fund was going to make the Blaszkiewiczes "a lot of money, and very little downside and tremendous upside . . . ." (Tr. 328:19—329:3; *see also* 357:17—358:2; 367:12-21);

b. Dembski "was the manager. He came up with this fund and he did a lot of paperwork on it, and he showed us reams of papers that were testing money, testing he did on it, and very, very good success with it, and we bought into it" (Tr. 330:11-19; 357:6—358:2);

c. There "was a supposed big bank, as he called it, or big financial outfit interested in investing millions of dollars in the fund" (Tr. 331:18—332:3; *see also* 359:13-23; 370:22—371:5); and

d. The Fund was guaranteed and insured by the FDIC. (Tr. 332:16—333:6; 360:3-13; Ex. 296.)

Though the Blaszkiewiczes knew Stephan, Stephan never participated in meetings with the Blaszkiewiczes about the Fund, and Dembski never explained that Stephan would have exclusive authority to make all investment decisions, something the Blaszkiewiczes would have wanted to know when making their own decisions about the Fund. (Tr. 330:20—331:14; 358:8-20.) Dembski also never disclosed that he was not permitted to monitor the Fund regularly. (Tr. 332:4-8.) Mr. Blaszkiewicz received Fund documents after he and Mrs. Blaszkiewicz made the decision to invest in the Fund. (Tr. 360:18—361:23; 339:22—341:2.)

After Mr. Blaszkiewicz learned that his investment lost over $30,000, Dembski told the Blaszkiewiczes that the Fund simply had a "glitch"; Dembski never told him that the Fund stopped using the computer to trade. (Tr. 333:7-334:13; 362:3-23.) After much persistence, and after losing approximately $38-40,000, the Blaszkiewiczes withdrew their money from the Fund. (Tr. 335:17—336:3; 345:25—346:4; 363:8-11.)

F. William Haubrick

William Haubrick, age ██ has lived in the Buffalo area for 69 years. Haubrick retired in 2002 after working as a metal worker in a maintenance department at Delphi Harrison.

(Tr. 381:18-24.) Haubrick first learned of the Prestige Fund from Dembski in early 2011; by that time, Dembski had been Haubrick's investment adviser for over ten years. (Tr. 391:7-21.)

Dembski told Haubrick the following about the Fund:

a. Dembski "had his own money in there" and "he had more money in this fund than [Haubrick] did"—Haubrick invested $250,000 in the Fund so Haubrick believed that Dembski had more than $250,000 invested in the Fund, which was important to him "because if [Dembski] is willing to put his own money up, I think it would be safe." (Tr. 383:19—384:16; 384:24—385:2);

b. The Fund "was a win/win and just a positive situation" (Tr. 384:17-23);

c. Stocks would be chosen on a daily basis and trades would be computer generated (Tr. 382:10-13); and

d. A friend of Dembski's who "was a computer expert" developed and generated how the computer would trade. (Tr. 382:14-18.)

Haubrick understood from Dembski that Dembski would run the Fund on a daily basis, which was important to Haubrick. (Tr. 383:7-18; 382:1-24.) In 2012, Haubrick "was worried about the investment. It was declining in value." (Tr. 385:23—386:10.) When Haubrick told Dembski he wanted to take his money out of the Fund, Dembski told him, "don't worry, it's fine" and that Dembski would take his money out by the end of 2012 if the Fund was not succeeding. (*Id.*) Shortly thereafter, Haubrick got a letter from Dembski saying that the Fund collapsed. (Tr. 386:21-25.) Haubrick called Dembski, who acknowledged he was not monitoring the Fund. (Tr. 387:8-16; 694:12-25.)

Haubrick was "shocked" when Dembski told him he was not monitoring the Fund because Haubrick—from Dembski's assurances—understood Dembski was going to be doing just that. (Tr. 387:22—388:4.) After the Fund collapsed, Haubrick got a statement about Stephan's bankruptcy, and that was the first time he learned that someone else was involved in running the Fund. (Tr. 388:5-16.) Haubrick would have found it important to know at the time he made his

investment decision that Stephan had exclusive authority to run the Fund because Haubrick did not know anything about Stephan. (Tr. 388:17-23.)

Haubrick lost all but $18,000 of his $250,000 investment. (Tr. 387:2-7; 396:12-16.)

G. Gregory Thuman

Gregory Thuman, age [redacted] has lived in the Buffalo area his entire life. Thuman retired in May 2014. (Tr. 418:6-8.) Dembski was Thuman's tax adviser for several years, starting in 2006 or 2007. (Tr. 418:16-18; 427:20—428:2.)

Dembski first told Thuman about the Fund in approximately 2010, and mentioned it to Thuman numerous times during Thuman's visits for tax services. (Tr. 418:23—419:5.) Thuman invested $250,000 in the Fund in May 2012 after Dembski told Thuman that he could invest half of his 401(k) in the Fund "to create an income stream in [his] retirement." (Tr. 419:10—420:4.)

Dembski told Thuman the following about the Fund:

a. The Fund engaged in day-to-day trading based on an algorithm; Dembski showed Thuman graphs on a computer—"he convinced us that that certainly looked like a legitimate way to track progress of this fund and the stocks, securities, and whatever you call them" (Tr. 420:13—421:2);

b. Dembski would manage the Fund and watch the stocks "on a day-to-day basis" (Tr. 421:3-17);

c. Dembski would place trades for the Fund (Tr. 423:15-20); and

d. Dembski invested his family members' money, including his mother's money and children's tuition, in the Fund, which made Thuman feel "very comfortable" and "secure" about his own investment. (Tr. 423:21—424:15.)

After Thuman expressed concerns about the Fund's contingency plans if something were to happen to Dembski, Dembski told him that Stephan "would be his backup." (Tr. 421:8-17.) When Thuman invested in the Fund, Dembski falsely told him that "it was a tested and proven algorithm that they've used and tweaked over the last couple of years"; Thuman "felt if they had been using it

successfully, great." (Tr. 424:16—425:5.) Based on what Dembski told him, Thuman believed that the algorithm had a "proven track record" using "real money" in "real time." (Tr. 425:6-20.)

Dembski presented the Fund materials to Thuman in Dembski's office the day Thuman invested in the Fund. (Tr. 433:6—434:19.) When Thuman told Dembski he did not understand the PPM, Dembski agreed the paperwork was "pretty intense stuff, and it would not be something that [Thuman] would probably relate to." (Tr. 425:21—426:23.) Thuman had separately discussed a potential investment in the Fund with Grenda, but Grenda recommended that Thuman not invest in the Fund because Grenda did not think Thuman sufficiently understood the risks. (Tr. 480:23—481:15.) Dembski knew of Grenda's advice to Thuman. (Tr. 592:20—593:19.) Thuman chose to trust Dembski when it came to the materials and paperwork for the Fund because Dembski was his "financial advisor on it. He was the person that I could rely on." (Tr. 427:10-15.)

Thuman received a letter from Dembski in January 2013 informing him that his Fund investment had lost 80% of its value. (Tr. 428:17-23.) After Thuman received the letter, he called Dembski, who said "he didn't have any information as to what happened. He was still digging into it" and all he knew was "some sort of a rogue trader [was] involved and he ha[d] to get to the bottom of it." (Tr. 428:24—429:11.) Thuman was surprised Dembski lacked information, because Dembski had claimed he would look at the Fund on a daily basis. (Tr. 429:12-15.)

Of his $250,000 investment, Thuman got back about $49,000. (Tr. 429:16-19.)

IV. Dembski Knew Many of His Oral Representations Were False and Misleading.

Dembski knew that no large bank ever expressed interest in investing millions of dollars in the Fund or in purchasing the Fund's trading formula (Tr. 103:2-15), nobody undertook any effort to patent the Fund's trading formula (Tr. 656:16—657:8; 103:16-22), and that the Fund was not

FDIC insured. (Tr. 103:23-25.)

In addition, Dembski never invested his own money in the Fund—but for $1,000 in seed money to open up the Fund's trading account—and he never invested his children's savings in the Fund. (Tr. 597:14-17; 104:12-19; 594:4-8; 104:24—105:3.) Furthermore, Dembski understood that the Fund's algorithm was developed by Stephan, not by Dembski. (Tr. 514:23—515:2.)

Dembski never intended—and believed he was not even permitted—to closely run, monitor or oversee the Fund. Indeed, Dembski and Stephan set up the Fund such that "Dembski would not have any decision-making powers over the investment/portfolio management of the fund." (Tr. 78:15—79:23; Ex. 10 at 1.) Stephan had that responsibility. (Tr. 79:24—80:3; Ex. 90 at 55; Ex. 88 at 2.) In practice, Dembski had no involvement in any trading or day-to-day investment decisions (Tr. 641:21—642:2; 83:15-18), or even access to the Fund's trading account. (Tr. 642:6-8; 83:19—84:25.)

Dembski admits telling investors he was "going to monitor the fund," but claims he meant only that he would monitor it "based on seeing Scott [Stephan] on a daily basis... and through [Fund] statements." (Tr. 624:17—625:6.) Dembski would only receive Fund statements if his clients or Stephan forwarded them to him. (Tr. 634:9-22.) Dembski "had no investment authority and did not regularly receive information about the Fund's performance." (Ex. 135 at 3.)

V. Dembski Denies Uttering All of His Oral Misrepresentations.

Dembski denies ever communicating virtually every misrepresentation investors described at the Hearing. (Dembski Br. at 4-14.) Confronted with so many witnesses contradicting his testimony, Dembski posits that investors' lawyers persuaded their clients to testify in certain ways, suggesting those investors were "coaxed into" taking a position against Dembski. (Dembski Br. at 14.)

Dembski has no such explanation for why his own sworn testimony changed over time. For example, Dembski denied at the Hearing that he told clients the Fund would perform better than their previous investments (Tr. 652:6-15), but he acknowledged making such statements in sworn testimony in May 2013. (Tr. 653:2—654:12.) Dembski also claimed at the Hearing that he told investors he was not allowed to play a role in selecting investments or trading for the Fund (Tr. 642:9-12), and that he told investors he "can't even see the fund." (Tr. 623:25—624:16; *see also* Tr. 585:8-21.) But Dembski admitted in March 2014 that he never told investors he would have "no involvement in the portfolio selection for the fund," saying that "never was a topic" he even discussed with investors and it never occurred to Dembski to raise that topic with them. (Tr. 642:16—644:2.) Asked by the Court to reconcile his prior sworn testimony with his claims at trial, Dembski could not do so. (Tr. 644:3—645:9.)

Dembski testified that the Court could expect to hear from some number of investors who would support his account of how he pitched the Fund to his clients (Tr. 625:24—627:16), but Dembski failed to call any such witnesses. (*See* Tr. 709:17—710:10.)

VI. Dembski Used a Materially False and Misleading PPM in Selling Fund Investments.

The PPM Dembski used in selling the Fund to his clients contained the following disclosures concerning Stephan's past work experience:

> Scott M. Stephan is co-founder and Chief Investment Officer of the General Partner. He has the exclusive responsibility to make the Fund's investment decisions on behalf of the General Partner. Mr. Stephan has worked in the financial services industry for over 14 years. The first half of his career he co-managed a portfolio of over $500 million for First Investors Financial Services. Afterwards, Mr. Stephan took a position as Vice President of Investments for a New York based investment company in which he was responsible for portfolio management and analysis.

(Ex. 90 at 55.)[4]

As Stephan acknowledged, this biography was "highly misleading." (Tr. 100:5-11; *see also* Stephan Answer at 1 ¶ 31; Tr. 52:5-8.) For example, Stephan never managed a securities portfolio of any size, let alone one over $500 million. (Tr. 95:16—96:6.) And Stephan was never a Vice President at Reliance Financial Group, Inc. ("RFG"), the Buffalo-based entity at which he was employed. (Tr. 489:24—490:2; Ex. 139 ¶ 16.)

The biography of a person given exclusive responsibility to make the Fund's investment decisions was a particularly important part of the PPM. "When investors pay a fee to invest, they are effectively paying for the expertise of a particular manager or managers with control over the investors' funds. Thus, information in a PPM about those individuals is of utmost importance." (Ex. 144 (Expert Report) at 16; *see also* Tr. 242:17—243:7.) Dembski conceded that he believed it was important for investors to meet Stephan precisely because of Stephan's role as the Fund's portfolio manager. (Tr. 662:22—663:10.)

Stephan's True Work Experience

Stephan did not have any experience with a hedge fund before the Prestige Fund, and he never invested or traded real money before. (Tr. 75:7-16.) Stephan is a high school graduate with one semester of college. (Tr. 52:9-13.) Stephan served as a medic for the United States Air Force for two years before being dishonorably discharged. (Tr. 52:16-53:2.) After leaving the Air Force, Stephan got a job at GE Capital in 1997 in Buffalo, New York, where he was a bill collector for "past due auto loans." (Tr. 53:6-14.)

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[4] Grenda used the same PPM despite knowing the truth about Stephan's work experience. (Tr. 488:7-16; 489:14—490:2; Ex. 143, citing May 23, 2013 Grenda Tr. at 117:4-21.)

In 1999, Stephan left GE Capital for a job at First Investors Financial Services ("First Investors") in Atlanta, Georgia. (Tr. 53:18—54:9.) At First Investors, Stephan "managed a call center of collectors that collected on past due auto loans." (Tr. 54:10-20.) Stephan stayed at First Investors until 2007, at which point he left Georgia to work with Dembski in Buffalo at RFG. (Tr. 54:21—55:5.) Stephan never had "anything to do … whatsoever with securitizing any loans or products of First Investors or anywhere else." (Tr. 96:13-16.) Before working at RFG, Stephan did not have any securities, trading or investing experience, and Stephen never told Dembski otherwise. (Tr. 60:6-14.)

Stephan did not trade or invest any securities for RFG or its clients. (Tr. 62:10—63:17.) Dembski and Grenda were responsible for portfolio management at RFG. (Tr. 97:10-13.)

Dembski Knew of Stephan's Experience Prior to Their Creation of the Fund.

Dembski was Stephan's close friend for many years before they launched the Fund together. (Tr. 663:11-14.) Stephan met Dembski in 1997 playing baseball, they became the "[b]est of friends" and "remain[ed] . . . best of friends" when Stephan moved to Georgia. (Tr. 55:6—56:21.) In fact, Dembski agreed to be the godfather to one of Stephan's children. (Tr. 57:16-18.)

Dembski knew that Stephan was in the collections business before coming to RFG. (Tr. 663:22-25.) When at GE Capital, Stephan told Dembski that he collected on past due auto loans (Tr. 55:16-25), and when at First Investors, Stephan told Dembski that he managed a call center for a group of collectors who collected on such loans. (Tr. 57:19—58:9.) Stephen never told Dembski that he was involved in securitizing auto loans when he was at First Investors or at any other employment he had. (Tr. 96:17-21.) Dembski also knew that before coming to RFG, Stephan was not involved in the securities business, had no experience working for any brokerage, and had no investment experience whatsoever. (Tr. 664:2-13.)

Dembski hired Stephan as a "telemarketer" for RFG. (Ex. 1 at 1; Tr. 59:9-14; 665:6-14.) In that role, after Dembski and Grenda sent "postcards to folks for upcoming events such as investment seminars ... [Stephan] would follow up on them and contact people that checked yes." (Tr. 61:12-21.) Stephan never had any clients of his own at RFG (Tr. 67:10-17), and Dembski knew this. (Tr. 665:15-17.) Stephan interacted daily with Dembski at RFG, and Dembski (along with Grenda) oversaw Stephan's work. (Tr. 60:19-21; 61:22—62:9.) When Dembski sold Fund investments to his clients, he knew Stephan did not have any background running a fund like the Prestige Fund. (Tr. 665:25—666:5.) But Dembski never told his clients about Stephan's lack of relevant experience. (Tr. 666:19—667:4.)

Dembski also knew that Stephan, when working at RFG, had personal financial difficulties and was unable to pay his mortgage and bills (Tr. 64:11—65:5), and Dembski knew that Stephan declared bankruptcy twice before starting the Fund. (Tr. 131:2-5.)

Dembski Understood the Stephan Biography Was False and Misleading.

When Dembski first read Stephan's biography, he understood that parts of the biography were inaccurate. (Tr. 679:14-18.) In particular, Dembski found the biography's reference to Stephan managing $500 million in securities to be incorrect. (Tr. 681:12—682:20; *see also* 680:12—681:3.) Dembski did not understand Stephan's biography's reference to 14 years of experience in the financial services industry, and Dembski believed, when he first read the biographical information, that the description of Stephan's work experience was "unclear" in light of what Dembski knew about Stephan's actual work experience. (Tr. 683:18—684:7.)

Dembski believed some of the biography language constituted "a gray area," by which he meant the disclosure might not be accurate. (Tr. 683:18—684:3; Ex. 142 at 2, citing Dembski Mar. 21, 2014 SEC Tr. at 160:10-24; *id.*, citing same testimony at 162:25—163:18; *id.*, citing same

testimony at 166:9—167:6.) Dembski also knew Stephan was not listed in RFG's corporate documents as a Vice President. (Tr. 515:3—516:7.) Dembski never shared with his clients that he thought Stephan's biography was a gray area, incorrect, and unclear. (Tr. 685:4-13.)

VII. Dembski Did Not Reasonably Rely on Any Legal Advice in Presenting His Clients with a False and Misleading PPM.

Dembski maintains attorneys wrote, approved, and even "urged" him to use the Fund's false and misleading PPM. (Dembski Answer ¶ 35.) But the Fund's attorneys played "no role in generating" the biographies beyond reviewing them "at a very high level for outrageous puffery that would seem incredibly misleading." (Tr. 820:16-821:13; *see also* 749:5-19; 751:10-20; 755:11-17; 799:17-20; 822:7—823:16; 93:12—94:13.)

Neither Dembski nor Stephan ever requested legal advice regarding the misrepresentations included in Stephan's biography before Dembski began utilizing the PPM. (Tr. 678:5-13; 753:21—754:2; 822:19-23; 99:10-15.) And Dembski and Stephan never received any such advice. (Tr. 678:23-679:3; 754:3-8; 822:24—823:16; 99:16-21.) Contrary to Dembski's contention (Dembski Br. at 19-20), Stephan never told Dembski that attorneys provided any such legal advice. (*See* Tr. 99:22—100:4; *see also* 93:17-21.)

Attorneys at the law firm Holland and Knight ("Holland") assisted Dembski and Stephan in forming the Fund. (Tr. 734:12-17.) Amy Rigdon was the Fund's primary contact at Holland. (Tr. 736:25—737:4; 818:16-23.) Holland relied on the Fund to provide factual information necessary for the attorneys to discharge their responsibilities. (Tr. 87:22—88:10; 737:11-16; Ex. 3 at PWM0000123.) Holland "had been very clear with the client all along that [they] relied on the factual information and expected it to be accurate when they provided it to us." (Tr. 747:8-25; *see also* 738:6-12; 821:14—822:6; 88:11-16.) In particular, Rigdon relied on Dembski and Stephan to

provide accurate descriptions of their professional experiences for use in the PPM. (Tr. 748:21—749:4.) Holland obtained the factual information they needed through the use of a questionnaire, supplemented with information obtained by phone or email. (Tr. 737:21—738:5; 534:17—535:9.)

On December 8, 2010, Rigdon asked Stephan and Dembski to provide information including "professional biographies for both [Stephan and Dembski] to include in the PPM." (Ex. 14 at 2.) As of December 8, Rigdon had not had "any discussions whatsoever with Mr. Dembski or Mr. Stephan about Mr. Stephan's professional background ... [or] biography." (Tr. 744:22—745:4; *see also* 539:15—540:9; 541:3-11 (describing other conversations with Holland attorneys.)

Dembski responded to Rigdon's December 8, 2010 email on December 9. Regarding the biographies, Dembski wrote: "We are working on them." (Ex. 14 at 1.) On December 13, Dembski sent draft biographies for Stephan and himself to Rigdon. (Ex. 15.) The language Dembski sent to Holland for use as Stephan's biography was, in all respects relevant in this matter, substantively identical to that in the final PPM. (*Compare* Ex. 15 *with* Ex. 90 at 55; Tr. 554:5-10.)

When Rigdon received the biographies from Dembski, she forwarded the drafts to Stephan to ensure he was aware Dembski had submitted them and, after making certain "grammatical" changes, "put them in the PPM." (Tr. 745:15-22; *see also* 746:21—747:7; 801:24—802:8.) Rigdon later sent Dembski and Stephan drafts of the PPM for their review and comment. (Tr. 751:21-25.) Dembski never provided any comments on the drafts, and Stephan's comments were limited to a bankruptcy-related disclosure. (Tr. 752:12-25.)

Rigdon still had not discussed with Stephan or Dembski their professional biographies when Rigdon sent Stephan and Dembski the final PPM on January 28, 2011 (Tr. 749:25—751:3; Ex. 21), or by February 1, 2011, the date listed on the face of the PPM. (Tr. 751:10-20.) Scott MacLeod, another Holland attorney who worked with the Fund, does not recall ever speaking with

Dembski during the time Holland worked on creating the Fund. (Tr. 817:15—818:15.)

Furthermore, Dembski never shared with his attorneys his belief that some of Stephan's biography constituted "a gray area" (Tr. 684:17—685:3), or his concerns about the accuracy of the balance of Stephan's biography. (Tr. 683:12-17; 840:11—841:11.) Even in 2013, when Dembski discussed Stephan's biography with counsel on a call he secretly (and illegally) recorded (Tr. 828:25—829:18), he failed to disclose Stephan's true work experience. (*See generally* Ex. 294 (recording at 9 min., 34 seconds); Ex. 295 (transcript at 11:8—12:5); Tr. 830:25—831:18.)

VIII. Dembski Had a Fiduciary Duty of Full Disclosure to His Clients.

As an investment adviser, Dembski had a fiduciary duty of full disclosure regarding any statements in the PPM he believed were not fully truthful "regardless of what a lawyer might say." (Tr. 253:7—255:12; *see also* Ex. 144 (Expert Report) at 10-11.) Dembski's fiduciary duties included "an affirmative duty of care, loyalty, honesty, and good faith to act in the best interests of [his] clients." (Ex. 144 at 11; *see also id.* at 15.) Dembski had a duty to carefully and thoroughly review Stephan's biography before using the PPM (Ex. 144 at 16)—but when he received the "final" PPM, he failed to do that. (Tr. 681:4-11.)

The fact that Dembski was offering Fund investments to mostly elderly and financially unsophisticated investors means that Dembski's "duties and obligations ... [were] much higher." (Tr. 243:8—244:11; Ex. 144 at 12.) In using a PPM Dembski knew to be inaccurate in parts and unclear in others, Dembski was not acting in accordance with industry custom and practice for investment advisers. (Ex. 144 at 20-21.)

IX. Dembski Blames His Clients for Not Understanding Prestige Fund Risks.

Dembski expected his clients to read the Fund's PPM "in its entirety." (Tr. 668:2-4.) But Dembski did not read the PPM in its entirety himself. (Tr. 668:17-25.) Dembski acknowledges he

did not understand certain parts of the PPM and believed there were portions his clients were unlikely to understand. (Tr. 669:2-8.) When asked by the Court how Dembski could reasonably believe investors read the PPM when he only read parts himself, Dembski explained that he thought his "clients read the most important things that could be understood," though he did not explain how those clients knew which parts to read or how Dembski knew what they could understand. (Tr. 669:14—671:2.)

Dembski also disregarded parts of the PPM when he disagreed with particular language. For example, Dembski testified that he did not consider the Fund to be a "speculative investment" (Tr. 691:19—692:11), even though the PPM specifically stated an "investment in the Fund is speculative." (Ex. 90 at 32.) And Dembski's statements to investors about taking their money out of the Fund whenever they chose to do so were contrary to the clear terms of the PPM, which set a 90-day minimum investment period absent special circumstances. (Ex. 90 at 63.)

X. Dembski Doctored a Personal Check He Produced to the SEC.

At the same time Dembski was profiting from Grenda's sale of Fund investments to Grenda's clients, Dembski was writing checks from his own personal account to Grenda. (Tr. 697:11-23.) Dembski denies paying Grenda any money for any reason relating to the Fund (Tr. 697:24—698:10), but among the checks Dembski wrote to Grenda was a $4,000 check with "PWM dist." included in the memo line. (Ex. 252; Tr. 698:11—699:14.) Dembski acknowledged that the "PWM dist." was written in his handwriting and that the writing stood for "PWM distribution." (Tr. 702:16—703:9.)

Dembski produced a version of that check to the SEC, but Dembski's copy inexplicably had no writing in the memo section. (Ex. 265.) Dembski could not explain why the memo was

deleted in the document he produced and pointed to his then-attorney as responsible for the production. (Tr. 700:22—701:4.) The ALJ drew the only logical conclusion from these facts: "Dembski appears to have doctored at least one document—a check—in order to conceal the fact that he had paid Grenda money for persuading Grenda's clients to invest in the Fund." ID at *26.[5]

XI. Dembski Profited from the Prestige Fund

Dembski sold Fund investments to his clients at Reliance Financial Advisors in his capacity as an investment adviser. (Tr. 630:14—631:2; Ex. 140 ¶ 2.) The Fund collected approximately $500,000 in total management and performance fees. Of that total, Dembski received $363,784.66. (Ex. 140 ¶ 4.)[6] Dembski received approximately two-thirds of the Fund's fees because Dembski advanced certain Fund expenses and he (and Grenda) supplied clients to invest in the Fund. (Tr. 639:15—640:2; 107:5-17; *see also* 73:21—74:8.) As Dembski admits, the $363,784.66 Dembski received in fees was more than he would have earned had he kept his clients' money invested as it was prior to investing in the Fund. (Tr. 696:16—697:10.)

XII. Dembski Seeks to Continue Working in the Securities Business

Dembski continues to serve as an investment adviser, among other roles, for many investors. (Tr. 602:22—605:5.) In fact, Dembski continues to add new clients. (Tr. 605:10-24.)

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[5] The doctored check was not the only instance of Dembski blurring the Fund's relationship with Grenda to further his fraudulent scheme. Dembski claimed Grenda had no authority to speak on behalf of the Fund (Tr. 693:6-8), but Dembski looked the other way when Grenda falsely informed the SEC on December 21, 2012 that the Fund would close by year's end. (Tr. 493:5—494:2.) Dembski did not intend to close the Fund at that time, but despite being aware of Grenda's December 21 letter (Tr. 695:2-11; 496:14-17; Ex. 34), Dembski decided against contacting the Commission to share the Fund's true plans. (Tr. 695:12—696:15; *see also* ID at *7.)

[6] Prejudgment interest on the $363,784.66 Dembski collected, calculated from December 7, 2012 (the last date on which Dembski received a share of the management and performance fees) through January 11, 2016 (the date of the ID in this matter) amounts to $34,125.50 using the Internal Revenue Service underpayment interest rate. Attached hereto as Appendix A is a copy of the Division's Prejudgment Interest Report showing the prejudgment interest calculation.

ARGUMENT

I. Dembski Violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

Dembski does not dispute the standard the ALJ applied to the Division's claims involving Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. (Dembski Br. at 22-23).[7] The Division must show that Dembski: "(1) made a material misrepresentation or a material omission as to which he had a duty to speak, or used a fraudulent device; (2) with scienter; (3) in connection with the purchase or sale of securities." *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999). "Essentially the same elements are required under Section 17(a)(1)-(3) in connection with the offer or sale of a security, though no showing of scienter is required ... under subsections (a)(2) or (a)(3)." *Id.* at 308; *see also* Dembski Br. at 23.

As Dembski notes, Rule 10b-5 "implements the SEC's authority under Section 10(b) of the 1934 Act in three 'mutually supporting' ways." (Dembski Br. at 22 (citations omitted). The same is true of Securities Act Section 17(a). (Dembski Br. at 23.) Accordingly, the ALJ found Dembski's "repeated, material misrepresentations" to violate not only Exchange Act Section 10(b), Rule 10b-5(b) and Securities Act 17(a)(2), but also to constitute a "device, scheme or artifice to defraud" and a "'practice or course of business' which defrauded his clients, in violation of Rule 10b-5(a) and (c) and Securities Act Section 17(a)(1) and (3)." ID at *18.

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[7] Dembski relies upon *John P. Flannery*, Exch. Act. Rel. No. 73840, 2014 WL 7145625 (SEC Dec. 15, 2015) for the Commission's position as to what constitutes violations of the various antifraud provisions encompassed by Section 10(b) of the Exchange Act and 17(a) of the Securities Act. (Dembski Br. at 22-23.) While *Flannery* has been vacated by the Court of Appeals for the First Circuit in *Flannery v. SEC*, 810 F.3d 1 (1st Cir. 2015), that decision did not alter the standards to which Dembski refers, which have support beyond the *Flannery* decision dating back decades. *See, e.g.*, *Cady, Roberts & Co.*, Exch. Act Rel. No. 6668, 40 SEC 907, 1961 WL 60638, at *4 (Nov. 8, 1961). Indeed, the ALJ embraced the same standards set forth in *Flannery* in his Initial Decision (while properly acknowledging the First Circuit's order vacating *Flannery* on other grounds). ID at *15-16.

Scienter is an intent to deceive, manipulate, or defraud. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 & n.12 (1976). "Scienter includes recklessness, defined as conduct that is 'an extreme departure from the standards of ordinary care ... to the extent that the danger was either known to the [respondent] or so obvious that the [respondent] must have been aware of it.' Thus, the 'scienter element can be satisfied by a strong showing of reckless disregard for the truth,' as well as actual knowledge of falsity." *Anthony Fields*, Rel. No. 4028, 2015 WL 728005, at *11 (S.E.C. Feb. 20, 2015) (quotations omitted).

A. Dembski Lied to Investors Orally

The record overwhelmingly supports the ALJ's finding (ID at *17) that Dembski lied repeatedly to his clients and that he knew his statements to those clients were untrue. (*See supra* at Section 6-15, 17-20.) And the ALJ was correct in finding that Dembski not only made affirmative misstatements, but also "omitted material facts he had a fiduciary duty to disclose to investors," including "that the Fund prohibited Dembski from playing any meaningful role in managing or running the Fund" and "that Stephan stopped using the Fund's computer algorithm to trade for the Fund in or around summer 2011." ID at *17. "[F]or the purpose of rule 10(b)-5, an investment adviser is a fiduciary and therefore has an affirmative duty of utmost good faith to avoid misleading clients. This duty includes disclosure of all material facts ...." *Laird v. Integrated Resources, Inc.*, 897 F.2d 826, 835 (5th Cir. 1990).

Dembski's Brief spends nearly ten full pages disputing that Dembski ever said the many false statements at issue, but the only evidence Dembski offers in support of that defense—and in opposition to eight clients' testimony and supporting documents—is his own self-serving testimony claiming each of his clients essentially perjured themselves. (Dembski Br. at 5-14.) The ALJ's "findings of fact reflect [a] determination that the testimony of the investor-witnesses

was more credible than that of Dembski regarding the oral representations he made to them about the Fund." ID at *2. The Commission should "give considerable weight to the credibility determination of a law judge since it is based on hearing the witnesses' testimony and observing their demeanor ... Such determinations can be overcome only where the record contains substantial evidence for doing so." *Robert M. Fuller*, Rel. No. 8273, 2003 WL 22016309, at *7 (Aug. 25, 2003) *pet. for review denied*, 95 F. App'x 361 (D.C. Cir. 2004); *see also ZPR Investment Mgmt., Inc.*, Rel. No. 4249, 2015 WL 6575683, at *16 (S.E.C. 2015) (citing *Fuller*).[8]

Here, there is no credible evidence to cause the Commission to doubt the ALJ's assessment of credibility. Instead, the record makes clear that Dembski made numerous oral misrepresentations to several investors and also provided potential investors with a written PPM he knew to be false and misleading. Dembski repeatedly assured the Court that there exist many clients who might bolster his credibility, but Dembski failed to call any such witness. As the ALJ explained: "I granted Dembski the right to call as many investor witnesses as he needed to establish that he did not make oral misrepresentations, but he failed to call any. In other words, faced with the undivided testimony of eight investor-witnesses against him, Dembski failed to call even one investor-witness to support his story." ID at *2.

Dembski's handling of a doctored bank check also reflects his lack of credibility.

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[8] Addressing the ALJ's credibility determinations, Dembski states that the "ALJ observed that 'all of the testifying investor-witnesses [may have] conspired to commit perjury.'" Dembski Br. at 25 (quoting ID at *2) (alterations in original). The sentence Dembski selectively excerpted reads, in full: "While it is not impossible that all of the testifying investor-witnesses conspired to commit perjury, I find it more plausible that they testified truthfully concerning what Dembski told them about the Fund." ID at *2. Thus, the ALJ *rejected* Dembski's contention that his testimony should be credited over that of all the investor-witnesses combined. The ALJ explained: "Dembski's theory that all of the investors and lawyers conspired to lie under oath is simply incredible and not supported by the evidence." Id. at *26.

> [I]n carrying out his fraud, Dembski appears to have doctored at least one document—a check—in order to conceal the fact that he had paid Grenda money for persuading Grenda's clients to invest in the Fund. Dembski suggested that his former counsel may have altered the document, but failed to provide any reasonable explanation as to why that counsel would have done so. It strains credulity that Dembski's former counsel would commit a crime to help his client. The person with the greatest incentive would have been Dembski. Dembski has demonstrated a troubling propensity to point the finger at others rather than accept responsibility for his wrongdoing.

ID at *26.

B. Dembski Knowingly Utilized a Materially Misleading PPM to Sell Prestige Fund Investments

The ALJ correctly found that "Dembski sold the interest in the Fund using a PPM which he knew falsely represented that Stephan had substantial relevant experience to run the Fund, when in reality he had none." ID at *17. *Supra* at 17-20. Dembski does not appear to contest the falsity of the PPM or his knowledge of that falsity. Instead, Dembski maintains that he used the PPM pursuant to the advice of Fund counsel. (Dembski Br. at 24.) But as the ALJ found, Dembski fails entirely to meet his burden of proving an advice-of-counsel defense. ID at *19.

As the party asserting an advice-of-counsel defense, Dembski bears the burden of establishing its essential elements. Thus, Dembski must "show that he made complete disclosure to counsel, sought advice as to the legality of his conduct, received advice that his conduct was legal, and relied on that advice in good faith." (*See* Dembski Br. at 24, quoting *SEC v. Markowski*, 34 F.3d 99, 104-105 (2d Cir. 1994).)

Here, there was no complete disclosure to counsel about Stephan's true work history—about which Dembski was well-aware—so counsel lacked sufficient information to render legal advice about the biography. Furthermore, neither Dembski nor anyone else sought any legal advice regarding the professional background described in Stephan's biography. To the

contrary, counsel made clear that the Fund was responsible for providing the factual information that would populate the PPM, and that is precisely what Dembski did when he sent counsel a draft biography of Stephan that included the very false and misleading statements for which he now seeks to blame his lawyers. And counsel never provided any legal advice about the statements at issue in Stephan's biography prior to Dembski using the PPM to sell Fund investments. Counsel simply received the draft biographies Dembski transmitted, made certain grammatical changes, and included them in the PPM.

Dembski's conflation of calls with Holland that took place *after* Dembski used the PPM to attract investments with conversations (or a lack thereof) occurring before the PPM was finalized do not support his defense. (Dembski Br. at 18, 21.) As MacLeod explained, when he finally was asked about Stephan's biography (long after it was finalized), he continued to suffer from the mistaken belief that Stephan had managed $500 million in "automobile receivables" in a previous job and thus had no reason to question the veracity of the PPM. As MacLeod further explained, if Stephan or Dembski had ever told him the truth—that Stephan's experience was "limited to bill collection or repo work"— he "wouldn't have said anything close to what [he] said" to Stephan. (Tr. 831:5-18.)

Dembski also cannot fashion an advice-of-counsel-defense based on counsel's general involvement in other aspects of setting up the Fund. (Dembski Br. at 17-21.) Attorneys' general involvement in launching the Fund is not sufficient where, as here, they did not provide any advice on the specific disclosures at issue. *See SEC v. Tourre*, 950 F. Supp. 2d 666, 684-85 (S.D.N.Y. 2013) (there is no "lawyers in the room" defense); *see also Fuller*, 2003 WL 22016309, at *6 n.31 (not recognizing defense of reliance on counsel concerning the propriety of a disclosure

where respondent failed to affirmatively seek advice or disclose to counsel the information counsel needed to know to render informed legal advice).

Finally, Dembski cannot credibly claim to have relied in "good faith" on any legal advice. Dembski admits he knew Stephan's biography was "incorrect" and otherwise "unclear," yet he never shared those concerns with the counsel he claims to have relied upon for advice regarding that biography. And as an investment adviser, Dembski had a duty of full disclosure that required him to tell clients the truth "regardless of what a lawyer might say." *Supra* at 23.

C. Dembski's Misrepresentations Were Material

A fact 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 (1988). As the ALJ found, the PPM's description of Stephan, the fund manager with exclusive authority to make investment decisions for the Fund, was "of utmost importance." ID at *17 (citation omitted). The record amply supports that conclusion, *see supra* at 13, 18, as does common sense. No reasonable investor would view Stephan's biography in the same light had it disclosed the truth—*i.e.*, "that Stephan only had a high school degree, had never managed investments before, had no prior experience with a hedge fund, had been dishonorably discharged from the military, and that his only professional experience consisted of collecting overdue auto loans and scheduling seminar attendees." ID at *18.

The materiality of Dembski's oral misrepresentations is similarly plain, and supported by every testifying investor. *See supra* at 6-15. Indeed, Dembski repetition of the same misleading statements confirms the materiality of those misrepresentations. *See United States v Philip Morris USA, Inc.*, 566 F.3d 1095, 1122-23 (D.C. Cir. 2009) (continuous repetition of statements indicates that such information was material).

D. Dembski's Misrepresentations Were Made in Connection with the Sale of Securities Involving Means of Interstate Commerce and the Mails

As Dembski tacitly concedes, his misrepresentations to his clients were made in connection with his effort to sell those clients Fund investments. (*See generally* Dembski Br.)

E. Blanket Risk Disclosures in the PPM Do Not Excuse Dembski's Many Oral Misrepresentations

The PPM's boilerplate risk disclosures do not save Dembski from liability for his oral and written misrepresentations, as such warnings do not render specific oral misrepresentations immaterial.[9] *See SEC v. Morgan Keegan & Co., Inc.*, 678 F.3d 1233, 1253 (11th Cir. 2012) (cautionary statement that securities "involved investment risks, including the loss of principal," "is insufficient to render its brokers' oral misrepresentations during that period immaterial as a matter of law.") For cautionary statements to be "meaningful," they must "discredit the alleged misrepresentations to such an extent that the real risk of deception drops to nil." *In re Bear Stearns Companies, Inc.* 763 F. Supp. 2d 423, 495 (S.D.N.Y. 2011) (quotations omitted).

As the ALJ explained, however, the cautionary statements in the PPM did not discredit Dembski's many misrepresentations. ID at *18, citing *Credit Suisse First Bos. Corp. v. ARM Fin. Grp., Inc.*, 99 CIV 12046, 2001 WL 300733, at *8 (S.D.N.Y. Mar. 28, 2001) ("[W]arnings of specific risks . . . do not shelter defendants from liability if they fail to disclose hard facts critical to appreciating the magnitude of the risks described."); *In re Prudential Sec. Ltd. P'ships Litig.*, 930 F. Supp. 68, 72 (S.D.N.Y. 1996) ("Cautionary language . . . must precisely address the substance of the specific statement or omission that is challenged.").

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[9] While Dembski asserts that the Division described the PPM as including "the most dramatically negative, cautionary terms that a hedge fund could utilize" (Dembski Br. at 15), the statement to which Dembski cites was not made by any Division witness or attorney; it was a statement by Dembski's own counsel.

Here, Dembski's attempt to hide behind the PPM's risk disclosures is particularly audacious, as Dembski admits he never read portions of the PPM, found parts of it difficult to understand, and believed his clients would be unable to understand the PPM's contents. Indeed, when investors expressed concern to Dembski about language in the PPM or of trouble understanding its meaning, but Dembski told them to disregard the PPM as "boilerplate" or "legalese." *Supra at* 7, 15.

F. Dembski Negligently Violated Sections 17(a)(2) and (3) of the Securities Act

The record separately establishes Dembski's liability for negligent violations of Section 17(a)(2) and (3) of the Securities Act. Investment advisers have a well-established duty to deal with their clients in "utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading [their] clients." *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963). Those duties were further heightened when Dembski dealt with vulnerable potential investors, such as his elderly, financially unsophisticated clients.

Dembski's fiduciary duties included "an affirmative duty of care, loyalty, honesty, and good faith to act in the best interest of [his] clients." *See supra* at 23. Dembski failed to discharge his duties when he orally misrepresented material facts about the Fund to his clients and failed to review the PPM before sharing it with his clients (or reviewed the PPM and distributed it notwithstanding concerns about the veracity of statements describing Stephan's experience).

II. Dembski Violated Sections 206(1) and (2) of the Advisers Act

"Section 206(1) of the Advisers Act prohibits 'any investment adviser' from 'employ[ing] any device, scheme, or artifice to defraud any client or prospective client,' and Section[] 206(2) ... prohibit[s] fraudulent and deceptive practices by investment advisers." *SEC v. Yorkville Advisors,*

LLC, No. 12 Civ. 7728 (GBD), 2013 WL 3989054, at *3 (S.D.N.Y. Aug. 2, 2013) (citations omitted). Section 206(1) requires a showing of scienter; a showing of negligence is sufficient to prove a violation of Section 206(2). *Id.*

Dembski's Brief is silent regarding violations of the Advisers Act but for one conclusory paragraph arguing the ALJ was wrong to conclude Dembski violated Sections 206 of that Act and the ALJ "misapplie[d] the statute." (Dembski Br. at 31.) Dembski's argument rises and falls on his assertion that the ALJ should have credited Dembski's testimony over all other witnesses' testimony, but that argument is no more persuasive as a defense to Advisers Act claims as it is for Exchange Act and Securities Act violations. Here, the same conduct supporting liability for fraud under the Securities Act and Exchange Act demonstrates liability under Section 206(1) and (2) of the Advisers Act. *See SEC v. Young*, 09 Civ. 1634 (JRP), 2011 WL 1376045, at *7 (E.D. Pa. Apr. 12, 2011) ("Facts showing a violation of Section 17(a) or 10(b) by an investment adviser will also support a showing of a Section 206 violations) (citation omitted); *SEC v. Blavin*, 557 F. Supp. 1304, 1315 (E.D. Mich. 1983) ("Once it is found that [defendant] is an investment adviser, which he was under the [Advisers] Act, all of the previous analysis establishing liability under 10(b) applies [to establish liability under the Advisers Act]"), *aff'd*, 760 F.2d 706 (6th Cir. 1985).[10]

III. Dembski Aided and Abetted and Caused Prestige LLC's and Reliance Financial Advisors' Violations of the Securities Act, Exchange Act and Advisers Act

Aiding and abetting liability requires proof of (1) the existence of a securities law violation by the primary party; (2) knowledge of the primary violation by the aider and abettor; and (3) substantial assistance by the aider and abettor in the achievement of the primary violation. *SEC v.*

[10] Dembski does not contest that Grenda and Reliance Financial Advisors also were investment advisers which, as discussed below, is relevant to the analysis of what primary violations Dembski aided and abetted and caused.

DiBella, 587 F. 3d 553, 566 (2d Cir. 2009); *see also Yorkville Advisors, LLC*, 2013 WL 3989054, at *3 (applying same standard to Advisers Act claims). "The knowledge or awareness requirement can be satisfied by recklessness when the alleged aider and abettor is a fiduciary or active participant." *SEC v. U.S. Pension Trust Corp.*, No. 07-22570-CIV, 2010 WL 3894082, at *22 (S.D. Fla. Sept. 30, 2010) (citation omitted).

"To establish liability for 'causing' violations in the absence of aiding and abetting, the Division must prove three elements: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) that the respondent knew, or should have known, that his conduct would contribute to the violation." *Fuller*, 2003 WL 22016309, at *4.[11]

Dembski aided and abetted and caused (i) Prestige LLC's and Reliance Financial Advisors' Securities Act and Exchange Act violations (ii) Reliance Financial Advisors' violations of Sections 206(1) and (2) of the Advisers Act, and (iii) Prestige LLC's violations of Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

Dembski ignores the ALJ's findings as to Dembski's aiding and abetting those entities' violations entirely, but for one statement claiming the "ALJ erroneously concluded that Mr. Dembski aided, abetted and caused Prestige's and Reliance Financial Advisor's (sic) violations [and there] was no evidence of Mr. Dembski's aiding, abetting and causation." (Dembski Br. at 32.) The ALJ properly found otherwise. Dembski knew the PPM he and Grenda (and therefore Reliance Financial Advisors) used was misleading (*supra* at 17-21), knew the Fund was being managed entirely by one person—Stephan—with virtually no investment experience (*id.*), knew of the Fund's growing problems, and its abandonment of the trading algorithm, even as he continued

[11] For primary violations requiring only negligence, Dembski's negligence satisfies the state of mind element for causing liability. *See Howard v. SEC*, 376 F.3d 1136, 1141 (D.C. Cir. 2004).

to solicit new investments (*supra* at 5-6, 8, 15), and was obviously aware of the false and misleading statements he was making orally to clients.

Dembski provided substantial assistance that contributed to Prestige LLC's and Reliance Financial Advisors' primary violations. "Substantial assistance" turns on whether each individual "in some sort associate[d] himself with the venture, that he participate[d] in it as in something that he wishe[d] to bring about, [and] that he [sought] by his action to make it succeed." *SEC v. Apuzzo*, 689 F.3d 204, 206 (2d Cir. 2012) (citation omitted). Dembski associated himself with the venture to obtain investments in the Fund when he, among other things, solicited clients he had through Reliance Financial Advisors to invest and provided those clients with the Fund's misleading PPM. Furthermore, Dembski co-owned the Fund, created its general partner, Prestige LLC, with Stephan, and was a principal of Reliance Financial Advisors. (*See supra* at 3.)

IV. Dembski's "Constitutional Rights" Arguments Have No Merit

Dembski states—without offering any supporting argument—that "the administrative proceeding was conducted in a manner that unfairly denied Mr. Dembski his constitutional rights to Due Process and fundamental principles of fairness." (Dembski Br. at 1.) To the extent his argument is that application of the Commission's Rules of Practice itself renders the administrative process unfair because the Commission's Rules differ from the federal rules, this argument lacks merit. It is well settled that the Federal Rules of Evidence and the Federal Rules of Civil Procedure do not apply in the Commission's administrative proceedings. *Ralph Calabro*, Securities Act Rel. No. 9798, 2015 WL 3439152, at *10 & n.66 (May 29, 2015). Any suggestion that this fact renders an administrative proceeding unfair has been consistently rejected by the courts. *See, e.g.*, *Cunanan v. INS*, 856 F.2d 1373, 1374 (2d Cir. 1988).

To the extent Dembski's complaint is, more broadly, that the administrative process is constitutionally inadequate, that too fails. As the Commission recently observed, "[s]uch broad attacks on the procedures of the administrative process have been repeatedly rejected by the courts." *Harding Advisory LLC*, Securities Act Rel. No. 9561, 2014 WL 988532, at *8 (Mar. 14, 2014). Courts have correctly recognized that to accept such challenges "would do considerable violence to Congress['s] purposes in establishing" specialized administrative agencies and would "work a revolution in administrative (not to mention constitutional) law." *Blinder, Robinson & Co. v. SEC*, 837 F.2d 1099, 1107 (D.C. Cir. 1988).

V. Relief Requested

The Division seeks to uphold the ALJ's relief award of (i) disgorgement of ill-gotten gains and prejudgment interest thereon; (ii) civil penalties; (iii) advisory and collateral bars; and (iv) a cease-and-desist order.

A. Dembski Should Disgorge His Ill-Gotten Gains and Pay Prejudgment Interest.

Dembski should disgorge the $363,784.66 in ill-gotten fees he collected through fraudulent sales of Fund investments. Dembski argues there is "no legitimate basis for [the] order of disgorgement" (Dembski Br. at 32), but offers offer any reason why he should be permitted to keep his ill-gotten gains. In fact, Dembski seems to confuse disgorgement with penalties, arguing under the subtitle "No Basis for Financial Penalties" that disgorgement is not warranted. (*Id.* at 27.)

But "the primary purpose of disgorgement as a remedy for violation of the securities laws is to deprive violators of their ill-gotten gains, thereby effectuating the deterrence objectives of those laws." *SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996) (citations omitted). Indeed, "effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable." *Id.* "Management fees and incentive fees are appropriately

disgorged where they constitute illgotten gains earned during the course of violative activities." *John Thomas Capital Mgmt. Group LLC*, ID SEC Rel. No. 693, 2014 WL 5304908, at *30 (SEC ID Oct. 17, 2014) (collecting cases) (review granted, Rel. No. 3978). Accordingly, Dembski should be ordered to disgorge profits he earned through fraudulent sales of Fund investments and to pay prejudgment interest of $34,125.50 to deprive him of an interest-free loan, thereby preventing unjust enrichment. *SEC v. Grossman*, No. 87 Civ. 1031, 1997 WL 231167, at *11 (S.D.N.Y. May 6, 1997), *aff'd in part and vacated in part on other grounds*, 173 F.3d 846 (2d Cir. 1999).

B. Dembski Should Pay Substantial Penalties.

Dembski argues that no penalties are warranted in this matter (Dembski Br. at 27), but the record and public interest demand otherwise. Under Section 8A(g) of the Securities Act, 15 U.S.C. § 77h-1(g), Section 21B of the Exchange Act, 15 U.S.C. § 78u-2, and Section 203(i) of the Advisers Act, 15 U.S.C. § 80b-3(i), the Commission may impose civil monetary penalties for respondents who willfully violated, aided and abetted, or caused a violation of, the provisions of the respective Acts at issue here if such penalties are in the public interest.[12] To determine what penalties are in the public interest, "Congress guides the Commission's discretion by pointing to six factors: (1) 'fraud,' etc., i.e., the feature required to be present for a second-tier penalty; (2) the harm to other persons; (3) the extent of unjust enrichment (taking into account restitution paid); (4) previous SEC findings of the violations by the offender; (5) the need to deter the offender 'and

[12] Section 21B(b) of the Exchange Act specifies a three-tier system identifying the maximum amount of civil penalties. Third-tier penalties are awarded where, as here, violations involve fraud, deceit, manipulation or deliberate or reckless disregard of a regulatory requirement and the conduct in question directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons, or resulted in substantial pecuniary gain to the person who committed the act or omission.

other persons'; and (6) a catch-all, 'such other matters as justice may require.'" *Collins v. SEC*, 736 F.3d 521, 524-25 (D.C. Cir. 2013) (citing 15 U.S.C. § 78u–2(c)).

As the ALJ found, he was authorized to award third-tier penalties of $150,000 for each violative act or omission. ID at *26. The penalty analysis here turns, in part, on many of the same facts that demonstrate Dembski's liability—*i.e.*, a finding that Dembski violated the antifraud provisions of the Securities Act, Exchange Act and Advisers Act makes clear that his violations involve "fraud." Furthermore, Dembski was enriched significantly by the fees earned from fraudulent sales of Fund investments, and the harm to investors was enormous.

Dembski's refusal to accept any responsibility for his actions also makes clear that deterrence will not be accomplished absent a significant penalty. This factor does not, as Dembski argues, place Dembski in the "*Catch 22*" predicament of needing to acknowledge his culpability while disclaiming liability. (Dembski Br. at 26.) Dembski could have argued that he should not be liable and still stopped short of blaming everyone around him for his own failings, but Dembski chose to blame virtually everyone other than himself for his fraud. Dembski blames his clients (for their "greed"), their lawyers (for coaxing investors to allegedly perjure themselves), the Division (for "coaching" investors, albeit with no factual support), the Fund's lawyers (for not catching that the biographical information Dembski sent them was false), and his personal attorney (for producing a doctored check to the SEC). But he never approaches accepting any responsibility for his own actions.[13] As the Commission has explained: "Although a respondent has the right to present a vigorous defense, we find that [a respondent's] continued attempts ... to shift blame and

[13] Dembski goes so far as to call his attorney's relationship with HedgeCo.—the company that referred Dembski to Holland and Knight—as "an act of bribery," though he offers no evidence in support of his claim or explanation for how such an accusation would support his defense. (Dembski Br. at 3, 17-18.)

minimize his role in deceiving investors demonstrate that he 'does not fully understand the seriousness of his misconduct and how it violated the duties of a securities professional' and 'presents a significant risk that, given th[e] opportunity, he would commit further misconduct in the future.'" *See Francis V. Lorenzo*, Rel. No. 9762, 2015 WL 1927763, at *14 (S.E.C. Apr. 29, 2015) (citations omitted).

The only factor Dembski can credibly claim in his favor is an absence of prior disciplinary history, but the ALJ took that into account in deciding to impose less than maximum third-tier penalties. ID at *25-26. In fact, the ALJ could have imposed third-tier penalties of up to $150,000 "for each" violative "act or omission" (*see* ID at *26; Advisers Act, § 203(i)(2)(C)), but chose to group together Dembski's many misstatements into "two categories of violations," the written misrepresentations included in the PPM and the ones Dembski communicated orally to his clients. ID at *26.[14] Moreover, Dembski's fraud reached approximately 43 investors over the course of nearly two years, so Dembski can hardly claim this case concerns the kind of isolated mistake that might make a lack of prior disciplinary record more relevant. *See Lorenzo*, 2015 WL 1927763, at *14 (finding public interest required industry bar despite relatively clean disciplinary record where respondent violated antrifraud provisions of securities laws by sending two misleading emails to investors).

Dembski cites several cases in purported support of his contention that the civil penalty and bar imposed by the ALJ is disproportionate to relief in other cases considered by the Commission. (Dembski Br. at 26-27.) As a threshold matter, "the Commission has consistently held that the

[14] As the Commission reviews the Initial Decision *de novo*, it may take a less generous approach. *See Ronald S. Bloomfield*, Rel. No. 9553, 2014 WL 768828, at *22-23 (S.E.C. Feb. 27, 2014), *vacated sub nom in part on other grounds*, *Robert Gorgia*, Rel. No. 9743, 2015 WL 1546302 (S.E.C. Apr. 8, 2015) (increasing penalties from those imposed by the ALJ).

'appropriate sanction depends upon the facts and circumstances of each particular case and cannot be determined precisely by comparison with actions taken in other proceedings.'" *Lorenzo*, 2015 WL 1927763, at *15. Moreover, the cases Dembski cites do not support his conclusion. *Mitchell H. Fillet* (Dembski Br. at 26) involved a Commission review of FINRA disciplinary proceedings in which the Commission found that FINRA failed to establish a violation of Exchange Act Rule 10b-5(b) (while sustaining violations of Rule 10b-5(a) and (c) and certain other violations). *Fillet*, Rel. No. 75054, 2015 WL 3397780, at *1 (May 27, 2015). Dembski asserts that the Commission "set aside an 8-month suspension and a $10,000 fine" (Dembski Br. at 26), but what the Commission actually did was remand the matter to FINRA to determine what sanctions were appropriate for those fraud violations the Commission upheld without "suggest[ing] any view as to the outcome of that reconsideration." *Fillet*, 2015 WL 3397780, at *13.

Dembski's reliance on *Patrick Lehnert* is similarly unavailing. In that matter, the Commission accepted a settlement offer in an insider trading case involving ill-gotten gains of $31,506. Rel. No. 75417, 2015 WL 4123718 (S.E.C. July 9, 2015). Dembski calls Mr. Lehnert's conduct "egregious" (presumably in comparison to Dembski's conduct) (Dembski Br. at 27), but he fails to support that claim or to note the isolated nature of the violations described in *Lehnert*.[15]

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[15] It is not clear why Dembski wishes to rely on *S.W. Hatfield* or *Steven Robert Tomlinson*. (Dembski Br. at 27.) In *Hatfield*, the Commission barred respondents permanently from appearing or practicing before the Commission as accountants and ordered payment of a penalty approximately equivalent to the disgorgement award ($112,529 disgorgement; $110,500 penalty). Rel. No. 3602, 2014 WL 6850921, at *1 (S.E.C. Dec. 5, 2014). A penalty approximating Dembski's ill-gotten gains in this case would *increase* Dembski's civil monetary penalty. *Tomlinson* involved a review of a FINRA order imposing sanctions for violating NASD Conduct Rule 2110. The Commission concluded that a ninety-day sanction for breaching and failing to safeguard confidential customer information was not excessive or oppressive, a holding that does not provide any support whatsoever for imposing anything less than a full industry bar on Dembski for his repeated fraudulent conduct. *Tomlinson*, Rel. No. 73825, 2014 WL 6985131, at *11 (S.E.C. Dec. 11, 2014).

C. Dembski Should Be Barred from Serving in the Securities Industry.

The relevant provisions of the Exchange Act, Advisers Act and Investment Company Act authorize bars from association with a "broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization" where such bars are in the public interest. 15 U.S.C. § 78o(b)(6)(A); *see also* Advisers Act Section 203(f), 15 U.S.C. § 80b-3(f) (authorizing bars); Investment Company Act of 1940 Section 9(b), 15 U.S.C. § 80a-9(b) (same). Such actions can be taken against any person who, among other things, willfully violated any provision of the Securities Act, Exchange Act or Advisers Act, or any of the rules and regulations promulgated under those statutes.

Dembski argues that bars should be reserved for only egregious cases. (Dembski Br. at 27.) As a case involving multiple violations of the antifraud provisions of the federal securities laws, this is precisely such a case. *Lorenzo*, 2015 WL 1927763, at *12 ("We have repeatedly warned that such violations of the antifraud provisions are 'especially serious and subject to the severest of sanctions under the securities laws.'") (citations omitted); *Jose P. Zollino*, Rel. No. IA-2579, 2007 WL 98919, at *5 (S.E.C. Jan. 16, 2007) ("conduct that violates the antifraud provisions of the federal securities laws is especially serious and subject to the severest sanctions.").

The public interest analysis requires consideration of the following factors, frequently called the "*Steadman* factors": (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infractions; (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 their conduct; and (6) the likelihood that their occupation will present opportunities for future violations. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979). As detailed above, each of these factors—which Dembski ignores entirely in his one page argument against a bar order

(Dembski Br. at 26-27)—favors the imposition of an industry bar without the right to reapply.[16]

D. A Cease and Desist Order Against Dembski Is Warranted.

The Commission is authorized to issue cease and desist orders where a person has, among other things, been found to have violated any provision of the Securities Act or Exchange Act, or the rules and regulations thereunder. Exchange Act Section 21C, 15 U.S.C. § 78u-3; Securities Act Section 8A, 15 U.S.C. § 77h-1; Advisers Act Section 203(k), 15 U.S.C. § 80b-3. Dembski's fraud demonstrates a conscious disregard of the federal securities laws, which is particularly troubling given his status as investment advisers charged with putting his clients' interests ahead of his own. Accordingly, cease-and-desist orders are appropriate to prevent violations and future violations of the statutes and rules set forth above.

CONCLUSION

Based on the foregoing, the Division respectfully requests that the Commission deny Dembski's appeal of the Initial Decision and impose on Dembski the sanctions requested herein.

Dated: New York, NY
April 22, 2016

Respectfully submitted,

DIVISION OF ENFORCEMENT

Michael D. Birnbaum
SECURITIES AND EXCHANGE COMMISSION
200 Vesey Street, Suite 400
Brookfield Place
New York, NY 10281
(212) 336-0523 (Birnbaum)

[16] A full industry bar is particularly appropriate when Dembski's conduct is considered relative to that of the Fund's co-founder, Scott Stephan. Stephan never communicated directly with Fund investors and has accepted at least some measure responsibility for his misconduct, but nevertheless agreed to a full industry bar as part of his offer of settlement.

APPENDIX A

U.S. Securities and Exchange Commission

Division of Enforcement

Prejudgment Interest Report

PJI Report for Timothy Dembski

Quarter Range	Annual Rate	Period Rate	Quarter Interest	Principal+Interest
Violation Amount				$363,784.66
01/01/2013-03/31/2013	3%	0.74%	$2,691.01	$366,475.67
04/01/2013-06/30/2013	3%	0.75%	$2,741.04	$369,216.71
07/01/2013-09/30/2013	3%	0.76%	$2,791.89	$372,008.60
10/01/2013-12/31/2013	3%	0.76%	$2,813.00	$374,821.60
01/01/2014-03/31/2014	3%	0.74%	$2,772.65	$377,594.25
04/01/2014-06/30/2014	3%	0.75%	$2,824.20	$380,418.45
07/01/2014-09/30/2014	3%	0.76%	$2,876.59	$383,295.04
10/01/2014-12/31/2014	3%	0.76%	$2,898.34	$386,193.38
01/01/2015-03/31/2015	3%	0.74%	$2,856.77	$389,050.15
04/01/2015-06/30/2015	3%	0.75%	$2,909.88	$391,960.03
07/01/2015-09/30/2015	3%	0.76%	$2,963.86	$394,923.89
10/01/2015-12/31/2015	3%	0.76%	$2,986.27	$397,910.16

Prejudgment Violation Range	Quarter Interest Total	Prejudgment Total
01/01/2013-12/31/2015	**$34,125.50**	**$397,910.16**

CERTIFICATE OF COMPLIANCE

I hereby certify pursuant to Rule 450(d) that the Division of Enforcement's Brief in Response to Respondent Timothy Dembski's Appeal of the Administrative Law Judge's Initial Decision complies with the length limitations set forth in Rule of Practice 450(c). The Division's Brief, exclusive of pages containing the table of contents and table of authorities, is 13,788 words.

By:
Michael D. Birnbaum

CERTIFICATE OF SERVICE

I hereby certify that on the date set forth below, I filed the foregoing pleadings with the Office of the Secretary of the Commission via facsimile at (202) 772-9324, and served copies on the following persons by UPS Next Day Air to:

Paul Batista, P.C.
26 Broadway, Suite 1900
New York, New York 10004

And by UPS Next Day Air and to alj@sec.gov upon:

Office of the Secretary (original plus three copies)
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

By:
Michael D. Birnbaum

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
New York Regional Office
Brookfield Place, 200 Vesey St., Suite 400
New York, NY 10281

DIVISION OF
ENFORCEMENT

Michael D. Birnbaum
Senior Trial Counsel
(212) 336-0523 (direct)
(212) 336-1319 (fax)

April 22, 2016

BY ELECTRONIC MAIL AND UPS

Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: ***Matter of Timothy S. Dembski*, File No. 3-16311**

Dear Mr. Fields:

Please find enclosed an original and three copies of the Division of Enforcement's Brief in Response to Respondent Timothy Dembski's Appeal of the Administrative Law Judge's Initial Decision.

Respectfully submitted,

Michael D. Birnbaum

cc (by email): Paul Batista, Esq.