

U.S. SECURITIES AND EXCHANGE COMMISSION

3-16312
ADMINISTRATIVE PROCEEDING
File No. 3-16312



In the Matter of

SCOTT M. STEPHAN,

Respondent.

RESPONDENT SCOTT M. STEPHAN'S
POST-HEARING MEMORANDUM

Respondent, by and through his attorney, ANDREW J. PACE, ESQ., submits this post-hearing memorandum.

PRELIMINARY STATEMENT

Mr. Stephan cannot pay disgorgements or fines. Mr. Stephan has previously submitted a Summary Financial Disclosure Statement along with copies of his pending bankruptcy petition and various other financial information. At the hearing conducted on May 11, 2015, Mr. Stephan testified to his inability to pay disgorgements or fines. Mr. Stephan's testimony was not controverted, nor was his credibility impeached, by either the SEC (on direct examination) or by Respondent Timothy Dembski's counsel (on cross-examination).

Even though Mr. Stephan consented to his liability, before the hearing, he testified about the absence of any intent, scheme or plan to defraud investors and he expressed deep remorse for his actions.

FACTUAL BACKGROUND

Mr. Stephan became an employee of Reliance Financial Advisors, LLC ("Reliance") in 2007. Tr. At 55. Mr. Stephan obtained securities license from FIRA, including a Series 7 license in August 2009, Series 63 license in August 2009 and a Series 66 license in October 2009. *Id.* at 66.

Mr. Stephan originated the concept of a hedge fund based on “a lot of market research on stocks,” such as “looking at charts...running through certain scenarios on the fluctuation of certain stocks on a daily basis.” Tr. at 69. Mr. Stephan used his research to developed a “formula” or “algorithm” which bought, held and sold stocks. Tr. at 68-70.

Before actively establishing Prestige Fund (“fund”), Mr. Stephan tested the formula by means of “MultiCharts”, a software program for “back testing where [he] could go back as far as seven years, put in a formula, and run through on a daily basis. *Id.* Mr. Stephan displayed the “back testing by utilizing independent programs such as “DTNIQ”. *Id.* at. 519. The back testing of the formula, as confirmed by an independent computer engineer, revealed “solid performance”. *Id.* at 521. Mr. Stephan and Mr. Dembski started the fund in 2011. *Id.* at 101-102.

Mr. Stephan developed the formula in “good faith” and had no intent to “cheat anyone in developing that formula.” *Id.* at 137-138.

Mr. Stephan had never worked at a hedge fund. Mr. Stephan and Mr. Dembski retained the law firm of Holland & Knight LLP (“Holland”) as corporate counsel. Mr. Stephan spoke with the attorneys at Holland 20 to 30 times during the formation of the fund. Tr. at 140. Holland advised Mr. Stephan that the fund required a Private Placement Memorandum (“PPM”). The PPM required a short biographical paragraph. Mr. Stephan described his working experience, in detail, to Holland, and Holland prepared and drafted the PPM. *Id.* at 143.

Unfortunately, even with the best intentions, the formula failed and the fund lost over 80% of its value between 2010 and 2012. Hedge fund failures are common. In fact, as much as one-third of all hedge funds close within their first three years. Lancaster, J. (2014, August). Money Talks. Retrieved from <http://www.newyorker.com/magazine/2014/08/04/money-talks-6>.

Based on the foregoing, the SEC initiated this proceeding by Order dated December 10, 2014.

ARGUMENT

MR. STEPHAN SHOULD NOT HAVE TO PAY DISGORGEMENTS OR FINES

A. Mr. Stephan’s Actions Do Not Warrant Further Punishment.

In assessing the appropriate amount of penalties, courts consider multiple factors, including: the egregiousness of the defendant's conduct; the degree of defendant's scienter; and whether the defendant's conduct was isolated or recurrent. *SEC v. Allen*, 2012 U.S. Dist. LEXIS 169135 (N.D. Tex. Nov. 28, 2012); *SEC v. Amerifirst Funding, Inc.*, No. 3:07-cv-1188-D, 2008 U.S. Dist. LEXIS 36782, 2008 WL 1959843, at 7 (N.D. Tex. May 5, 2008) (quoting *SEC v. Opulentica*, 479 F. Supp. 2d 319, 331 (S.D.N.Y. 2007)).

Here, the SEC's claims against Mr. Stephan are simple: that he was not forthcoming with the investors. At the hearing, Mr. Stephan acknowledged that he should have been crystal clear in the PPM biography. Mr. Stephan apologized for not being more transparent to both Mr. Dembski and the investors. He also took full responsibility for the fund's performance

Without diminishing the seriousness of the allegations, it is safe to say that this is not "egregious" conduct. Nor is this a case where scienter is even an issue. In *Ernst and Ernst v. Hochfelder*, 425 U.S. 185, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976), the U.S. Supreme Court described scienter as "a mental state embracing intent to deceive, manipulate, or defraud." At no time did Mr. Stephan intend to deceive investors. His biography was puffed up and he didn't talk much to the investors. Mr. Stephan did not steal money from the investors- let alone intentionally defraud the investors.

With regards to recidivism, this proceeding is Mr. Stephan's first appearance before the SEC (or any court for that matter). He is not a repeat offender. Mr. Stephan has never been disciplined or fined by a governmental or self regulation organization. What's more, Mr. Stephan will never again work in the financial services industry. Mr. Stephan has signed an Offer of Settlement dated November 12, 2014 in which he consented to a full bar from the financial services industry and acknowledged violations of several vague statutes under the Securities Act of 1933 and its progeny.

When considering fines some courts consider factors such as "cooperation of the defendant with law enforcement authorities and the adequacy of other criminal or civil sanctions to punish the defendant." *SEC v. Lewis*, 492 F. Supp. 2d 1173, 1174 (D.S.D. 2007); *SEC v. Church Extension of the Church of God, Inc.*, 429 F. Supp. 2d 1045, 1050-51 (S.D. Ind. 2005)).

Since 2013, Mr. Stephan has met with, been interview by, and testified before the

attorneys at the SEC. Mr. Stephan has been open and honest with the SEC. There has been no wasteful motion practice or litigious brinkmanship. Unfortunately the SEC has not given Mr. Stephan credit for his cooperation.

"While these factors are helpful in characterizing a particular defendant's actions, 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." *Id.* (quoting *Opulentica*, 479 F. Supp. 2d at 331).

The facts here do not beg for further punishment. To the contrary, in this particular case, Mr. Stephan should not have to pay disgorgements or fines.

B. Mr. Stephan Cannot Pay Disgorgements or Fines.

Ability to pay is a factor to be considered in imposing a penalty. *SEC v. Monterosso*, 756 F.3d 1326, 1338 citing *SEC v. Warren*, 534 F.3d 1368 at 1370 (11th Cir. Ga. 2008). In assessing the appropriate amount of penalties, courts consider whether the penalty should be reduced due to the defendant's demonstrated current and future financial condition. *SEC v. Allen*, at 6. The ability to pay must be established by a preponderance of the evidence. *See SEC v. Harris*, No. 3:09-cv-1809-B, 2012 U.S. Dist. LEXIS 31394, 2012 WL 759885, at 5 (N.D. Tex. Mar. 7, 2012) (citing *SEC v. Huffman*, 996 F.2d 800, 803 (5th Cir. 1993)).

[REDACTED]. Mr. Stephan has provided documentary evidence which supports his testimony. In accordance with Securities and Exchange Commission Rule 630 and the Court's Order from May 4, 2015, Mr. Stephan has provided: (1) Form D-A: Disclosure of assets and financial information; (2) copies of Mr. Stephan's proposed 1040 Federal Income Tax Returns for the years 2011, 2012, 2013 and 2014; (3) Copies of W-2 Tax Forms for Mr. Stephan and his wife, [REDACTED], for the years 2011, 2012 and 2013; (4) Copies of the Stephans' most recent Bank of America joint checking account statements, from February 14, 2015 to April 17, 2015; (5) A copy of the Stephans' Voluntary Petition for Bankruptcy, Chapter 7, filed on December 6, 2013 in the U.S. Bankruptcy Court for

the Western District of New York.

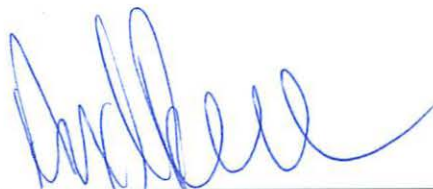
Further punishing Mr. Stephan now will not serve remedial interests and will work only as an excessive and punitive result. *McCarthy v. SEC*, 406 F.3d 179 (2d Cir. 2005). Mr. Stephan has clearly met his burden of proving an inability to pay by a preponderance of the evidence.

CONCLUSION

For the foregoing reasons, respondent Scott M. Stephan respectfully requests that Court not impose disgorgements or fines.

Dated: Orchard Park, New York
June 30, 2015

Respectfully submitted,



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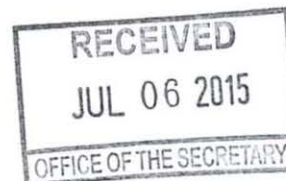
Karen A. Bishop
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James L. Essenson, of counsel
Sarasota, Florida

July 1, 2015

SENT VIA OVERNIGHT MAIL AND EMAIL FieldsB@SEC.GOV

U.S. Securities & Exchange Commission
Office of the Secretary
Brent Fields, Secretary
100 F Street, NE
Mail Stop 1090
Washington, DC 20549



**RE: Matter of Scott Stephan / File No. 3-16312
Post-Hearing Memorandum**

Dear Mr. Fields:

Enclosed please find Respondent Scott M. Stephan's Post-Hearing Memorandum and a cover letter addressed to Hon. Jason Patil.

If you have any questions or require further information, please do not hesitate to contact me.

Very truly yours,

ANDREW J. PACE

Cc: Hon. Jason Patil *via email*
Tony M. Frouge, Esq. *via email*
Michael Birnbaum, Esq. *via email*
Paul Batista, Esq., *via email*



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July 1, 2015

SENT VIA MAIL AND EMAIL ALJ@SEC.GOV

Hon. Jason S. Patil, ALJ
U.S. Securities & Exchange Commission
100 F Street, NE
Mail Stop 1090
Washington, DC 20549



**RE: Matter of Scott Stephan / File No. 3-16312
Post-Trial Memorandum**

Dear Judge Patil:

Enclosed please find Respondent Scott M. Stephan's Post-Hearing Memorandum.

There has been some confusion between Messrs. Birnbaum, Frouge, Batista and I with regards to the submission(s) of Proposed Findings of Fact and Conclusions of Law ("PFFCL"). My client and I have reviewed Respondent Timothy Dembski's PFFCL, submitted by Mr. Batista on June 30, 2015. In order to save time and avoid redundancy, please allow Mr. Dembski's PFFCL to serve also as Mr. Stephan's PFFCL. My client is in full agreement with the PFFCL submitted by Mr. Batista.

Mr. Stephan asked me to thank you again for allowing he and I to appear at the May 11th hearing.

If you have any questions or require further information, please do not hesitate to contact me.

Very truly yours,

ANDREW J. PACE

Encls.

Cc: Tony M. Frouge, Esq. *with enclosures*
Michael Birnbaum, Esq. *via email*
Paul Batista, Esq., *via email*