UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINITRATIVE PROCEEDINGS
File No. 3-17228

In the Matter of **David S. Hall, P.C., d/b/a The Hall Group CPAs,** **David S. Hall, CPA,** **Michelle L. Helterbran Cochran, CPA, and** **Susan A. Cisneros** **Respondents.**	**HALL RESPONDENTS' BRIEF IN OPPOSITION TO THE DIVISION OF ENFORCEMENT'S MOTION FOR PARTIAL SUMMARY DISPOSITION**

Respondents, David S. Hall, P.C., d/b/a The Hall Group CPAs (the "Hall Group") and David S. Hall, CPA, ("Mr. Hall") (collectively the "Hall Respondents"), by and through their undersigned attorneys, hereby submit the following brief in opposition to the Motion for Partial Summary Disposition ("Motion") filed by the Division of Enforcement ("Division") of the United States Securities and Exchange Commission ("Commission" or "SEC"), pursuant to 17 C.F.R. §§ 201.250 and 201.154. The Division's Motion should be denied for the same reasons that Respondents seek to dismiss this action in its entirety as set forth in their Motion for Summary Disposition ("Respondents' Motion") filed on July 1, 2016. Respondents' Motion argues that this case should be dismissed under the doctrine of res judicata (claim preclusion) because the claims share the same nucleus of operative facts as the action before the Public Company Accounting Oversight Board ("PCAOB" or "Board"). Because the Commission's claims in this case should be dismissed in their entirety, the Division's Motion as to some of those claims lacks merit and should be denied.

STATEMENT OF THE CASE

On April 26, 2016, the PCAOB, after extensive investigation entered an Order, to which Respondents consented, censuring the Hall Respondents. ("PCAOB Order"). That very same day the Commission entered an Order Instituting Public Administrative and Cease-and-Desist Proceedings ("OIP") pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, based on the same nucleus of facts and the same documents already produced by the Hall Respondents.

The PCAOB Order determined, among other things, that the Hall Group and Mr. Hall individually violated PCAOB rules and auditing standards in connection with the audits of the financial statements of three issuer clients. The three audit clients were Seven Arts Entertainment Inc. ("Seven Arts"), Freestone Resources, Inc. ("Freestone") and Medient Studios, Inc. ("Medient"). The audits as to which violations occurred were the FY 2012 (June 30, 2012 year-end) audits of Seven Arts and Freestone and FY 2012 (December 31, 2012) audit of Medient. The findings of violations included findings that as to two of the audits the Hall Group did not have an engagement quality reviewer ("EQR") appointed who possessed the level of knowledge and competence required to perform engagement quality reviews and as to the third Mr. Hall served as both engagement partner and the EQR. PCAOB Order at 3, ¶¶ 3-4.

The PCAOB Order made other findings, including that the Hall Group, Mr. Hall and others working under his direction altered, added to and backdated archived workpapers in connection with the PCAOB's 2103 inspection of the firm's records for the 2012 Seven Arts audit. *Id.* at ¶¶ 5, 37-38. Finally, the PCAOB Order determined that at all relevant times Mr. Hall was the Hall Group's sole owner, was the engagement partner for each of the three audits, was in charge of the firm's issuer audit practice and that he took or omitted to take actions knowing, or

recklessly not knowing that his acts and/or omissions would directly and substantially contribute to the Hall Group's violations of the PCAOB's rules and auditing standards. *Id.* at ¶¶ 7, 43.

The OIP contains virtually identical allegations as to the three audits referenced in the PCAOB Order and adds allegations as to an additional 13 audits and 35 review engagements conducted during the same time as the subjects of the PCAOB Order, including audits and review engagements for the same audit clients during fiscal year 2013.

More importantly for the present opposition, the Division's Motion is based in part on the very same audit clients, Seven Arts and Medient, and as to Medient the very same audit of FY 2012. Division's Motion at 11. And further, regardless of the audit client involved, the misconduct alleged in the Division's Motion is in substantial part based upon the same misconduct as found in the PCAOB's Order: the absence of a qualified EQR or Mr. Hall's serving as both engagement partner and the EQR.

Based upon the above findings, the PCAOB imposed sanctions against the Hall Group and Mr. Hall individually under various sections of the Sarbanes Oxley Act and the PCAOB rules censuring the firm and Mr. Hall, barring Mr. Hall from associating with a registered public accounting firm for a minimum of three years and revoking the Hall Groups registration with the PCAOB. As a consequence of the PCAOB's Order under Section 105(c)(7)(B) of Sarbanes Oxley, Mr. Hall was also prohibited from associating in an accountancy or financial management capacity with any issuer registered with the Commission.

As set forth in detail in Respondents' Motion, the Commission had de novo authority to review all PCAOB disciplinary actions, including the PCAOB Order entered against Respondents and had the power to enhance, modify, cancel, reduce or require remission of sanctions imposed by the Board. Further, the Board had to notify the Commission of its

investigations of Respondents and could have referred its investigations to the Commission. The Board was required to coordinate its investigations with the Commission and shared with the Commission confidential information obtained in the course of its investigation. *See* 15 U.S.C. § 7215(4), (5) (2016); Respondents' Brief in Support of their Motion at pp. 6-9.

As a result of these powers and obligations, the PCAOB and the Commission are in privity with each other so the acts, enforcement actions and decisions of the PCAOB constitute the acts of the Commission. The claims asserted in the OIP relating to violations of the standards of the PCAOB were the subject of the PCAOB investigation and enforcement action that was settled. The fact the Division's OIP was dated the very same date as the PCAOB Order demonstrates that the PCAOB and the Division were sharing the same information at the same time and could have brought one action. Consequently, the Division's assertions in the OIP of the same claims that were or could have been asserted by the PCAOB are barred in whole or in part by the doctrine of claim preclusion.

ARGUMENT

I. Legal Standards

The Commission may grant a motion for summary disposition under Rule 250 of the Commission's Rules of Practice, 17 C.F.R. §201.250 and Rule 154, 17 C.F.R. §201.154. For purposes of the motion, the facts of the pleading of the party against whom summary disposition is sought "shall be taken as true, except as modified by stipulations or admissions made by that party, by uncontested affidavits, or by facts officially noted pursuant to Rule 323." Rule 250(a). The Commission modeled Rule 250 on Federal Rule of Civil Procedure 56. The burden is on the Commission to proffer evidence to demonstrate why summary disposition is appropriate. The motion can be granted only if there is no genuine issue as to a material fact and the party making the motion is entitled to a summary disposition as a matter of law. Rule 250(b).

II. The Doctrine of Res Judicata (Claim Preclusion) Bars the SEC's Claims against the Hall Respondents.

The Supreme court has confirmed a "longstanding view" that "[w]hen an administrative agency is acting in a judicial capacity and resolves disputed issues of fact properly before it which the parties have had an adequate opportunity to litigate, the courts have not hesitated to apply res judicata to enforce repose." *B&B Hardware, Inc. v. Hargis Indus., Inc.*, __ U.S. __, 135 S.Ct. 1293, 1303 (2015). *See also* Restatement (Second) of Judgments § 83(1) ("a valid and final adjudicative determination by an administrative tribunal has the same effects under the rules of res judicata, subject to the same exceptions and qualifications, as a judgment of a court"). Under the doctrine of res judicata , or claim preclusion, "a final judgment on the merits of an action precludes the parties or their privies from relitigating issues that were or could have been raised in that action." *San Remo Hotel, L.P. v. City & Cty. of S.F., Cal.*, 545 U.S. 323, 336 n.16 (2005); *Allen v. McCurry*, 449 U.S. 90, 94 (1980); *San Remo Hotel, L.P. v. City & Cty. of S.F., Cal.*, 545 U.S. 323, 336 n.16 (2005)(same). The party asserting res judicata has the burden of proving it. *King v. Galluzzo Equip. & Excavating, Inc.*, 2001 WL 1402996, *7 (E.D.N.Y. Nov. 8, 2001).

In order for res judicata to bar the Commission from bringing this proceeding, each of the following four elements must be satisfied: "(1) the parties are identical or in privity; (2) the judgment rendered in the prior action was rendered by a court of competent jurisdiction; (3) the prior judgment was concluded to a final judgment on the merits; (4) the same claim or cause of action was involved in both claims." *Thanedar v. Time Warner, Inc.*, 352 Fed. Appx. 891, 897-98 (5th Cir. 2009) (quoting *Southmark Corp. v. Coopers & Lybrand*, 163 F.3d 925, 934 (5th Cir. 1999).

(1) **The PCAOB is in Privity with the Commission. Congress Delegated Certain Disciplinary Power to the PCAOB as the Commission's Closely-Supervised Representative.**

The Sarbanes-Oxley Act of 2002 (or Act) was enacted in the wake of the massive accounting and corporate governance scandals at Enron, WorldCom, and other public companies. It vested the PCAOB with broad governmental powers and responsibilities. *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 484 (2010). Through this 2002 legislation the PCAOB was born.

a. The SEC's Control Over the PCAOB is Virtually absolute.

The SEC's "control over the [PCAOB] is virtually absolute . . . ." *Id.* at 530.[1] The Supreme Court explained that the PCAOB differs from other "self-regulatory organizations" because it is "a Government-created, Government-appointed entity, with expansive powers to govern an entire industry. *Id.* at 485. The extensive powers of the PCAOB outlined by the Court include:

> The Board is charged with enforcing the Sarbanes–Oxley Act, the securities laws, the Commission's rules, its own rules, and professional accounting standards. §§ 7215(b)(1),(c) (4). To this end, the Board may regulate every detail of an accounting firm's practice, including hiring and professional development, promotion, supervision of audit work, the acceptance of new business and the continuation of old, internal inspection procedures, professional ethics rules, and "such other requirements as the Board may prescribe." § 7213(a)(2)(B).
>
> The Board promulgates auditing and ethics standards, performs routine inspections of all accounting firms, demands documents and testimony, and initiates formal investigations and disciplinary proceedings. §§ 7213–7215 (2006 ed. and Supp. II). The willful violation of any Board rule is treated as a willful violation of the Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. § 78a et seq.—a federal crime punishable by up to 20 years' imprisonment or $25 million in fines ($5 million for a natural person). §§ 78ff(a), 7202(b)(1) (2006 ed.). And the Board itself can issue severe sanctions in its disciplinary proceedings, up to

[1] "The role of the [PCAOB] . . . in virtually every respect is subordinate to that of the Commission, which has oversight of the Board." 3G Harold S. Bloomenthal & Samuel Wolff, Sec. & Fed. Corp. Law § 30:22 (2d ed.).

> and including the permanent revocation of a firm's registration, a permanent ban on a person's associating with any registered firm, and money penalties of $15 million ($750,000 for a natural person). § 7215(c)(4). Despite the provisions specifying that Board members are not Government officials for statutory purposes, the parties agree that the Board is "part of the Government" for constitutional purposes, *Lebron v. National Railroad Passenger Corporation*, 513 U.S. 374, 397, 115 S.Ct. 961, 130 L.Ed.2d 902 (1995), and that its members are "'Officers of the United States' " who "exercis[e] significant authority pursuant to the laws of the United States," *Buckley v. Valeo*, 424 U.S. 1, 125–126, 96 S.Ct. 612, 46 L.Ed.2d 659 (1976) (per curiam) (quoting Art. II, § 2, cl. 2). . . .

Id. at 485-86. *See also* 15 U.S.C. §§ 7211(c) (Duties of Board).

The Commission exercises broad powers of review over PCAOB activities. The Act empowers the Commission to review any Board rule or sanction. See 15 U.S.C. §§ 7217(b)(2)-(4), (c)(2). Not only are PCAOB disciplinary decisions directly appealable to the Commission, but the Commission has the power to review them on its own motion. 15 U.S.C. § 7217(c)(2)(A). Once the Commission has acted, an appeal lies with the appropriate United States Court of Appeal.

The Board is "a heavily controlled component" of the Commission. *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 537 F.3d 667, 680 (D.C. Cir. 2008), *aff'd in part, rev'd in part and remanded*, 561 U.S. 477(2010). "No Board rule is promulgated and no Board sanction is imposed without the Commission's stamp of approval. Indeed, any policy decision made by the Board is subject to being overruled by the Commission." *Id.* The Board's exercise of its statutory duties is "subject to check by the Commission at every significant step." *Id.* at 673. "[B]y statutory design the Board is composed of inferior officers who are entirely subordinate to the Commission and whose powers are governed by the Commission." *Id.* at 680, n.9. "The Commission's authority over the Board is explicit . . . comprehensive . . . . [and] extraordinary" *Id.* at 669 (citing 15 U.S.C. § 7217, 7218). The Act ensures that all Board functions are "subject to pervasive Commission control . . . ." *Id.* at 681.

"Privity is a legal conclusion designating a person so identified in interest with a party to former litigation that he represents precisely the same right in respect to the subject matter involved." *Headwaters Inc. v. U.S. Forest Serv.*, 399 F.3d 1047, 1053 (9th Cir. 2005) (internal punctuation omitted) (quoting *Sw. Airlines Co. v. Tex. Int'l Airlines, Inc.*, 546 F.2d 84, 94 (5th Cir. 1977)). Given the Commission's total domination and control of the PCAOB, the Commission is in privity with the PCAOB. *Estevez v. Nabers*, 219 F.2d 321, 322 (5th Cir.1955) ("the government, its officers, and its agencies are regarded as being in privity for [res judicata] purposes").

b. The PCAOB is in effect a disciplinary arm or agent of the SEC.

The Act gives the Board "the power to adopt rules and standards 'relating to the preparation of audit reports'; to adjudicate disciplinary proceedings involving accounting firms that fail to follow [Board] rules; to impose sanctions; and to engage in other related activities, such as conducting inspections of accounting firms registered as the law requires and investigations to monitor compliance with the rules and related legal obligations." *Free Enterprise*, 561 U.S. at 528 (citing 15 U.S.C. §§ 7211–7216). The following statutes exemplify the extent to which the PCAOB acts as an agent and disciplinary arm of the SEC:

- "No Accounting Board rule takes effect unless and until the Commission approves it," *id.* (citing § 7217(b)(2));
- "The Commission may 'abrogat[e], delet[e] or ad[d] to' any rule or any portion of a rule promulgated by the Accounting Board whenever, in the Commission's view, doing so 'further[s] the purposes' of the securities and accounting-oversight laws," *id.* (citing § 7217(b)(5);
- "The Commission may review any sanction the Board imposes and 'enhance, modify, cancel, reduce, or require the remission of' that sanction if it find's the Board's action not 'appropriate,'" *id.* (citing §§ 7215(e), 7217(c)(3));

- "*The Commission may promulgate rules restricting or directing the Accounting Board's conduct of all inspections and investigations*," *id.* (citing §§ 7211(c)(3), 7214(h), 7215(b)(1)-(4)) (emphasis in original);

- "*The Commission may itself initiate any investigation or promulgate any rule within the Accounting Board's purview*," *id.* (citing § 7202), "and may also *remove any Accounting Board member who has unreasonably 'failed to enforce compliance with' the relevant 'rule[s], or any professional standard*,'" *id.* (citing § 7217(d)(3)(C)) (emphasis in original);

- "*The Commission may at any time 'relieve the Board of any responsibility to enforce compliance with any provision' of the Act, the rules, or professional standards if, in the Commission's view, doing so is in 'the public interest*,'" *id.* (citing § 7217(d)(1)) (emphasis in original).

- "[T]he Commission has general supervisory powers over the Accounting Board itself: It controls the Board's budget, *id.* at 529 (citing §§ 7219(b), (d)(1));

- "[The Commission] can assign to the Board any 'duties or functions' that it 'determines are necessary or appropriate,'" *id.* (citing § 7211(c)(5));

- "[The Commission] has full 'oversight and enforcement authority over the Board,'" *id.* (citing § 7217(a)), "*including the authority to inspect the Board's activities whenever it believes it 'appropriate' to do so*," *id.* (citing § 7217(d)(2)) (emphasis in original).

- "[The Commission] can censure the Board or its members, as well as remove the members from office, if the members, for example, fail to enforce the Act, violate any provisions of the Act, or abuse the authority granted to them under the Act," *id.* (citing § 7217(d)(3)).

These statutory provisions "make clear . . . . the Commission's control over the Board's investigatory and legal functions is *virtually absolute*." *Id.* (emphasis added).

(2) <u>The PCAOB Order was rendered by a court of competent jurisdiction</u>

The PCAOB had proper jurisdiction. The PCAOB "is charged with enforcing the Sarbanes-Oxley Act, the securities laws, the Commission's rules, its own rules and professional accounting standards." *Free Enterprise*, 561 U.S. at 485 (citing §§7215(b)(1), (c)(4)). It "demands documents and testimony, and initiates formal investigations and disciplinary proceedings." *Id.* (citing 15 U.S.C. §§ 7213-7215). Moreover, Respondents admitted the Board's

jurisdiction over them and the subject matter of the proceedings in connection with their consent to the entry of the PCAOB Order. PCAOB Order at 2, ¶ II.

(3) Consent Decrees are Final Judgments on the Merits and are to be Accorded Res Judicata Effect.

The PCAOB Order is a final judgment on the merits and is accorded res judicata effect. The Board made determinations of fact and conclusions of law. *See* PCAOB Order at 2-8; *see also Tutt v. Doby*, 459 F.2d 1195, 1199 (D.C.Cir.1972) (preclusive effect of a consent decree limited, if the court did not make determinations of fact and conclusions of law). *See United States v. Southern Ute Indians*, 402 U.S. 159, 160 (1971)(upholding consent judgment); 1B J. Moore, Moore's Federal Practice ¶ 0.409[5] (2d ed. 1983). Application of res judicata to consent decrees has the salutory effects of (1) making efficient use of judicial energy devoted to individual cases, (2) establishing certainty and respect for court judgments, and (3) protecting the party relying on the prior adjudication from vexatious litigation. See *Semler v. Psychiatric Inst. of Wash., D.C.*, 575 F.2d 922, 927 (D.C.Cir.1978).

Although the PCAOB's five members are appointed by the SEC, "some-but not all-of the PCAOB's regulatory actions require[] SEC approval in the form of a final Commission order." *Tilton v. SEC*, _ F.3d _, 2016 WL 3084795, *4 (2d Cir., June 1, 2016). The Supreme Court noted that the Act "empowers the Commission to review any Board . . . sanction," but does not require it. *Free Enterprise*, 561 U.S. at 489 (citing 15 U.S.C. §§ 7217(b)(2)-(4), (c)(2)[2]).

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[2] Section 7217(c)(2) provides:
(2) Review of sanctions
The provisions of sections 78s(d)(2) and 78s(e)(1) of this title shall govern the review by the Commission of **final disciplinary sanctions imposed by the Board** (including sanctions imposed under section 7215(b)(3) of this title for noncooperation in an investigation of the Board), as fully as if the Board were a self-regulatory organization and the Commission were the appropriate regulatory agency for such organization for purposes of those sections 78s(d)(2) and 78s(e)(1) of this title, except that, for purposes of this paragraph—
. . . .

PCAOB Rule 5204(d) governs when determinations in disciplinary proceedings are final, providing:

> (1) An initial decision as to a party shall become the final decision of the Board as to that party upon issuance of a notice of finality by the Secretary[3].
>
> (2) Subject to subparagraph (3) of this paragraph, the Secretary shall issue a notice of finality no later than 20 days after the lapsing of the time period for filing a petition for review of the initial decision.
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> (3) The Secretary shall not issue a notice of finality as to any party
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> (i) who has filed a timely petition for review; or
> (ii) with respect to whom the Board has ordered review of the initial decision pursuant to Rule 5460(b).

(Effective pursuant to SEC Release No. 34-49704, File No. PCAOB-2003-07 (May 14, 2004); and SEC Release No. 34-72087, File No. PCAOB-2013-03 (May 2, 2014)).

a. PCAOB discipline of its members precludes disciplinary action by the SEC, because it was final.

The PCAOB Order imposed final disciplinary sanctions. Sections 78s(d)(2)[4] and 78s(e)(1)[5] of Title 15 govern the review by the Commission of final–disciplinary sanctions

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(B) references in that section 78s(e)(1) of this title to "members" of such an organization shall be deemed to be references to registered public accounting firms;
(C) the phrase "consistent with the purposes of this chapter" in that section 78s(e)(1) of this title shall be deemed to read "consistent with the purposes of this chapter and title I of the Sarbanes-Oxley Act of 2002";
(D) references to rules of the Municipal Securities Rulemaking Board in that section 78s(e)(1) of this title shall not apply; and

. . . .

15 U.S.C.A. § 7217(c)(2)(B)-(D) (2016)(emphasis added).

[3] The term "Secretary" means the Secretary of the Board. PCAOB Rule 1001(s)(vi). (Effective pursuant to SEC Release No. 34-49704, File No. PCAOB-2003-07 (May 14, 2004); and SEC Release No. 34-72087, File No. PCAOB-2013-03 (May 2, 2014)).

[4] Section 78s(d)(2) provides:
(2) Any action with respect to which a self-regulatory organization is required by paragraph (1) of this subsection to file notice **shall be subject to review by the appropriate regulatory agency for such member, participant, applicant, or other person, on its own motion, or upon application by any person aggrieved** thereby filed within thirty days after the date such notice was filed with such appropriate regulatory agency and received by such aggrieved person, or within such longer period as such appropriate regulatory agency may determine. **Application to such appropriate regulatory agency for review, or the institution of review by such appropriate regulatory agency on its own motion**, shall not operate as a stay of such action unless such appropriate regulatory agency otherwise orders . . . .

imposed by the Board. There is no evidence that the PCAOB applied to the SEC for review; nor was it required to do so. 15 U.S.C.A. § 78s(d)(2). There is no evidence that the SEC on its own motion sought to review the PCAOB Order; nor was it required to do so. 15 U.S.C.A. § 78s(e)(1)(A).

(4) The Claims Asserted Against The Hall Respondents in this Commission Action Were or Could Have Been Asserted in the PCAOB Action.

The SEC's claims are barred because "the rights sought to be enforced by [the SEC in this second action] stem from the same transaction out of which the original action arose, and thus could have and should have been brought in the original action." *May v. Parker-Abbott Transfer & Storage, Inc.*, 899 F.2d 1007, 1010 (10th Cir. 1990); *see also Thanedar*, 352 F. App'x at 898 (5th Cir. 2009)(finding all three of Thanedar's claims arose from the same core set of facts); *Int'l Union of Operating Eng'rs–Emp'rs Const. Indus. Pension, Welfare & Training Trust Funds v. Karr*, 994 F.2d 1426, 1430 (9th Cir.1993) (same); *Hanley v. Aperitivo Rest.Corp.*, 1998 WL 307376, *5 (S.D.N.Y. June 11, 1998)(following Second Circuit – same); *King v. Galluzzo*

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15 U.S.C.A. § 78s(d)(2) (2016)(emphasis added).

[5] Section 78s(e)(1)(A) provides:

(e) Disposition of review; cancellation, reduction, or remission of sanction

(1) In any proceeding to review a **final disciplinary sanction imposed by a self-regulatory organization** on a [registered public accounting firm] . . . or participant therein or a person associated with such a [registered public accounting firm] . . . , after notice and opportunity for hearing (which hearing may consist solely of consideration of the **record before the self-regulatory organization** and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the sanction)—

(A) if the appropriate regulatory agency for such [registered public accounting firm]. . . participant, or person associated with a [registered public accounting firm] . . . finds that such [registered public accounting firm] . . . participant, or person associated with a [registered public accounting firm] . . . has engaged in such acts or practices, or has omitted such acts, as the self-regulatory organization has found him to have engaged in or omitted, that such acts or practices, or omissions to act, are in violation of such provisions of this chapter, the rules or regulations thereunder, the rules of the self-regulatory organization, or, in the case of a registered securities association . . . as have been specified in the determination of the self-regulatory organization, and that such provisions are, and were applied in a manner, consistent with the purposes of this chapter [and title I of the Sarbanes-Oxley Act of 2002], such appropriate regulatory agency, by order, shall so declare and, as appropriate, affirm the sanction imposed by the self-regulatory organization, modify the sanction in accordance with paragraph (2) of this subsection, or remand to the self-regulatory organization for further proceedings; or

. . . .

15 U.S.C.A. § 78s(e)(1)(A) (2016)(emphasis added; reflects changes set forth in 15 U.S.C.A. § 7217(c)(2) (B)-(D)).

Equip. & Excavating, Inc., 2001 WL 1402996, *9 (E.D.N.Y. Nov. 8, 2001)(same; collecting cases).

The Fifth Circuit applies a transactional test to determine whether two suits involve the same cause of action. *Ellis v. Amex Life Ins. Co.*, 211 F.3d 935, 938 (5th Cir. 2000). "[T]he critical issue is whether the two actions under consideration are based on "the *same nucleus of operative facts.*" *Southmark*, 163 F.3d at 934 (emphasis in original). See *Cavil v. Ocwen Loan Servicing LLC*, 2013 WL 145039, at *3 (S.D. Tex. Jan. 11, 2013) (same claims, same allegations even though styled in an exotic fashion). "Under this approach, the operative facts define the claims, not the relief requested, legal theories, or rights asserted. *Thanedar*, 352 Fed.Appx. at 898 (citing *Agrilectric Power Partners, Ltd. v Gen. Elec. Co.*, 20 F.3d 663, 665 (5th Cir. 1994).

In determining whether different facts will give rise to a different cause of action, the court considers, among other things, "whether the facts are related in time, space, origin, or motivation, whether they form a convenient trial unit, and whether their treatment as a unit conforms to the parties' expectations or business understanding or usage." *Serpas v. D.C.*, 2005 WL 3211604, *4 (D.D.C. Oct. 29, 2005)(citation omitted); *see* 1B J. Moore, Moore's Federal Practice ¶ 0.410[1] (2d ed. 1983) (same); Restatement (Second) of Judgments, § 24 (1982)(same).

"[The] transaction may be single despite different harms, substantive theories, measure or kind of relief." *Nilsen v. City of Moss Point*, 701 F.2d 556, 560 n.6 (5th Cir.1983). "[O]ne who has a choice of more than one remedy for a given wrong . . . may not assert them serially, in successive actions, but must advance all at once on pain of bar." *Id.* at 559. Where material factual allegations overlap, "the facts essential to the barred second suit need not be the same as the facts that were necessary to the first suit. It is instead enough that 'the facts essential to the

second were [already] present in the first.' " *Waldman v. Village of Kiryas Joel*, 207 F.3d 105, 110–11 (2d Cir.2000) (citations omitted; emphasis in original). "[A] plaintiff cannot avoid the effects of res judicata by 'splitting' his claim into various suits, based on different legal theories (with different evidence 'necessary' to each suit)" *Id.* at 110 (citations omitted). The essential question is whether the overlapping facts are sufficiently related to each other so as to constitute a single transaction or series of transactions. *Id.* at 111.

The core elements of the conduct and actions alleged in the PCAOB proceeding overlap substantially those alleged in the OIP. Neither the addition of allegations regarding particular instances of misconduct, nor the addition of facts alters the core elements of the conduct that the PCAOB and the Commission complained of. Both proceedings arise from the Hall Group's audits and review engagements for public company clients during 2012 and 2013. Both proceedings allege failures to separate the function of engagement partner from EQR and the whether Mr. Hall as the owner of the Hall Group was factually and legally responsible for the Hall Group's alleged misconduct. The *res judicata* "bar will apply when the subsequent facts are merely additional examples of the earlier-complained of conduct, such that the action remains based principally upon the shared common nucleus of operative facts." *Cameron v. Church*, 253 F.Supp.2d 611, 620 (S.D.N.Y. 2003)(citing *Waldman*, 207 F.3d at 113). The causes of action asserted in the OIP are therefore barred by *res judicata.*

As such, "[t]he final judgment puts an end to the cause of action, which cannot again be brought into litigation between the parties upon any ground whatever." *Nevada v. United States*, 463 U.S. 110, 130 (1983) (internal quotations omitted). Therefore, res judicata "bars all claims that were or could have been advanced in support of the cause of action on the occasion of its former adjudication, . . . not merely those that were adjudicated." *Nilsen*, 701 F.2d at 560.

Contrary to the findings in *Gordon Brent Pierce*, Securities Act of 1933 Release No. 9555, 2014 WL 896757, at *9-10, cited in the ALJ's July 7, 2016 Order, p. 2, the cause of action in the first proceeding, need not be identical to the cause of action in the second proceeding. The Commission in *Gordon Brent Pierce*, did not apply the transaction test recognized by the Fifth Circuit and the D.C. Circuit. This action by the Commission is based on the same nucleus of operative facts as the action by the PCAOB. The nature of the statutory scheme of the Sarbanes–Oxley Act and the relationships between the parties under it reveal that the PCAOB's enforcement action was the same cause of action as the Commission's current enforcement action.

(a) Consent Judgments are given Res Judicata Effect.

The transactional approach is used to determine the preclusive effect of a consent agreement. *In re Medomak Canning*, 111 B.R. 371, 373-74 (D. Me), *aff'd* 922 F.2d 895 (1st Cir. 1990); *In re Grenert*, 108 B.R. 1, 4 (D. Me. 1989). In *Shearman v. Asher*, 2003-0152 (La. App. 4 Cir. 7/2/03); 851 So. 2d 1226, 1229, Mr. Shearman brought suit against Mr. Asher and his accounting firm for actions taken when Mr. Asher was serving as a court appointed liquidator of the law firm ("accounting malpractice suit"). Mr. Asher and his accounting firm argued that res judicata applied because Mr. Shearman agreed to release and indemnify Mr. Asher "for any of his actions as a liquidator." Mr. Asher also argued, in part, that Mr. Shearman had entered into a consent judgment, compromised and settled all past and future claims against Mr. Asher as the liquidator of the law firm in the liquidation action. The test, the court determined, was whether the subject matter of the accounting malpractice suit arose from the same transaction or occurrence of Mr. Asher's actions as a liquidator. The court noted that in the liquidation suit, the issue was the proper distribution of the assets of the law firm. Ultimately, the law firm's lawyers

entered into a consent judgment, which settled any possible claim that could arise out of the liquidation of the law firm and provided for distribution of the law firm's assets. The court determined that the accounting malpractice suit arose out of the *same nucleus of facts* as the liquidation suit, the indemnity agreement, and the consent judgment. The issue of Mr. Asher's professional negligence, the court concluded, could have been raised in the liquidation suit, and the consent judgment did not *specifically* reserve the right of Mr. Shearman to bring another action on the issue. Thus, Mr. Shearman's second suit against Mr. Asher arising out of his actions as judicial liquidator in the dissolution of the law firm was barred by res judicata. Citing the Restatement (Second) of Judgments, § 26 (1982), the court noted that exceptions exist to the common law theory of res judicata, such as "where (a) the parties have agreed that the plaintiff may split his claim, or the defendant has acquiesced therein; or (b) the court in the first action has expressly reserved the plaintiff's right to maintain the second action." *Id.*

(b) There was No Express Reservation in the PCAOB Order.

The PBAOC Order did not *expressly* reserve the right of the PBAOC or the SEC to bring another action against the Hall Respondents on the same issues. The settlement agreement in this case did not expressly reserve the right to sue; the implications argued from general language did not establish an agreement to permit claim splitting. *Pactiv Corp. v. Dow Chem. Co.*, 449 F.3d 1227, 1230–1232, n.2 (Fed. Cir. 2006) (settlement agreement did not expressly reserve the right to sue; the implications argued from general language did not establish an agreement to permit claim splitting); *Epic Metals Corp. v. H.H. Robertson Co.*, 870 F.2d 1574, 1577 (Fed. Cir. 1989) (stating that an express reservation "must be discerned within the four corners of the consent decree, and cannot be expanded beyond the decree's *express* terms")(citing *United States v. Armour & Co.*, 402 U.S. 673, 681–83 (1971)); *Urbanizadora Santa Clara, S.A. v. United States*,

207 Ct.Cl. 297, 518 F.2d 574, 578 (1975) ("If plaintiff intended to preserve and pursue a claim ... following the execution of the release, it was incumbent on plaintiff to manifest this intention in a *clearly recognizable manner....*"); *Russell v. SunAmerica Securities, Inc.*, 962 F.2d 1169, 1176-1177 (5th Cir. 1992) (holding that the relationship between Southmark and SunAmerica was "close enough to justify the application of res judicata so as to bar a second suit based on the same cause of action as the first suit . . . where . . . the gravamen of the Plaintiffs' second suit [wa]s that the defendant in that suit [wa]s a mere continuation of the defendant in the first suit"); *Polak v. Riverside Marine Const., Inc.*, 22 F. Supp. 3d 109, 125 (D. Mass. 2014), *appeal dismissed* (Nov. 26, 2014) (Consent Decree could not be interpreted as an express reservation by the Board to reserve Polak's right to maintain federal maritime claims);

The parties in the present case never agreed that the PBAOC, acting in privity with the SEC, could split the claims already asserted. Nor did the parties "*expressly reserve*" the right of the PBAOC acting in privity with the SEC to maintain a second action. Restatement (Second) of Judgments, §26(b)[6]. The governments use of deliberately vague terms such as "[t]he findings herein are made pursuant to Respondents' Offers and are not binding on any other person or entity in this or any other proceeding" did not "expressly reserve" the right of the PBAOC acting in privity with the SEC to maintain a second action.[7] The Restatement (Second) of Judgments, §

[6] The general rule of § 24 does not apply to extinguish the claim if " (b) The court in the first action has *expressly* reserved the plaintiff's right to maintain the second action . . . . " Restatement (Second) of Judgments § 26 (1982) (emphasis added).

[7] *Compare, In the Matter of Benjamin W. Young, Jr.*, Release No. 445 (S.E.C. Release No.ID-445), 102 S.E.C. Docket 2561, 2011 WL 740580 (Dec. 16, 2011)(stating: "entry of permanent injunction may have collateral consequences under federal and state law and the rule and regulations of other organizations."); and *Gibson v. S.E.C.*, 561 F.#d 548, 551 (6th Cir. 2009)("the court's entry of a permanent injunction may have collateral consequences" and agreed that "[i]n any disciplinary proceeding before the Commission based on the entry of the injunction in this action, [he] shall not be permitted to contest the factual allegations of the Complaint [filed in district court] in this action."

26 (1982)[8] recognizes that there must be an express reservation of the right to maintain a second action.

The transactional approach is used to determine the preclusive effect of a consent agreement. The claims asserted in the OIP arose out of the *same nucleus of facts* as the PCAOB Order and are related in time, space, origin, and motivation. Consent to further litigation was not expressly reserved by the PCAOB or the SEC. Therefore, Commission's claims are precluded under claim preclusion.

(c) The Government is bound by the Sanctions imposed by the PCAOB

"When the Commission chooses to seek penalties administratively, it must either preside over the proceeding itself or designate a hearing officer—usually an ALJ—to do so." *Tilton v. Sec. & Exch. Comm'n*, __ F.3d __, 2016 WL 3084795, at *2 (2d Cir. June 1, 2016) (citing 17 C.F.R. § 201.110). "A presiding ALJ has authority to issue an initial decision, which may become final only by order of the Commission." *Id.* (citing § 201.360). In this case, it is the same ALJ that presided over the PCAOB proceedings that has been appointed by the PCAOB to review his same findings. The role of the PCAOB is subordinate to the SEC in virtually every respect.[9] The sanctions imposed by the PCAOB are no different.

1. Sanctions Imposed by the PCAOB as Agent for SEC Supplant those of the SEC

The disciplinary sanctions that can be imposed by the PCAOB are extensive and rival what can be imposed by the SEC.

- A civil penalty "for each" violation that cannot exceed $100,000 for a natural person and $2 million for any other person, unless the Board finds intentional,

[8] The Supreme Court] in this action." has recognized and applied the Restatement (Second) of Judgments in agency decisions and issue preclusion. See B&B hardware, 135 S.Ct. 1293 at 1303.

[9] The members of the PCAOB are appointed by the SEC and are terminable at will by the SEC. *Free Enterprise*, 561 U.S. at 510.

knowing or reckless violations or repeated instances of negligent conduct each resulting in a violation. 15 U.S.C.A. § 7215(c)(5).

- The Board can impose a civil penalty for each violation of not more than $750,000 for a natural person and $15 million for any other person. , 15 U.S.C.A. § 7215(c)(4)(D)(ii).
- Temporary suspension or revocation of a firm's registration; temporary or permanent bar of an associated person; temporary or permanent limitation of activities and functions can be imposed upon a finding of intentional, knowing or reckless violations or repeated instances of negligent conduct each resulting in a violation. 15 U.S.C.A. § 7215(c)(5).
- The Board may impose sanctions on the firm and/or supervisory personnel of the firm for failure to reasonably supervise an associated person who is subject to sanctions under the Act. 15 U.S.C.A. § 7215(c)(6)(A).

A full panoply of sanctions and penalties are available to the PCAOB. The PCAOB was required to file with the SEC notice of any final disciplinary sanction imposed on the Hall Respondents. 15 U.S.C.A. § 7217(c)(1). The SEC was given general oversight responsibility and enforcement authority over the PCAOB. 15 U.S.C.A. § 7217(c)(2).[10] The review procedures provide for review of the decision of the PCAOB upon the SEC's own motion. The Commission never availed itself of this option. If the conduct was so egregious to warrant such extreme additional penalties as the Division now seeks, surely the Commission could and should have reviewed the PCAOB Order at the time. 15 U.S.C.A. 78s(d)(2). The SEC may affirm, set aside, or modify the PCAOB's sanctions, or remand for further proceedings, after notice and opportunity for hearing. The Commission never took this action. The hearing may consist of the record developed before the Board with an opportunity for the parties to present reasons to affirm, modify, or set aside the PCAOB's decision. 15 U.S.C.A. 78s(e)(1). As to sanctions

[10] 15 U.S.C.A. §§ 7217(c)(1), (c)(2), (c)(3) were held unconstitutional or preempted by *Free Enterprise Fund*, 561 U.S. 477 (2010) and are subject to the following legislation: 2015 CONG US S 89, 114th CONGRESS, 1st Session (Jan. 07, 2015), VERSION: Introduced in Senate, PROPOSED ACTION: Amended; 2015 CONG US S 107, 114th CONGRESS, 1st Session (Jan. 07, 2015), VERSION: Introduced in Senate, PROPOSED ACTION: Repealed; 2015 CONG US HR 171, 114th CONGRESS, 1st Session (Jan. 06, 2015), VERSION: Introduced in House, PROPOSED ACTION: Amended.

imposed by the PCAOB, the SEC's authority specifically permits it to "enhance, modify, cancel, reduce, or require the remission" of any sanction imposed by the PCAOB. 15 U.S.C.A. § 7217(c)(3)[11]. This sanction authority, however, is subject to question post *Free Enterprise Fund.* The SEC was in privity with the PCAOB and claim preclusion is a bar to the imposition of further penalties. *Harmon Indus., Inc. v. Browner*, 191 F.3d 894, 902-904 (8th Cir. 1999)(consent judgment with state released Harmon from any claim for monetary penalties; EPA imposed monetary penalties in administrative proceedings; EPA was in privity with state officials and claim preclusion barred civil penalties).

2. Denial of Opportunity for Hearing on Sanctions

Through its motion for summary disposition, the Division seeks to deny the Hall Respondents an "opportunity for hearing" on the additional sanctions that the Division seeks to impose through the OIP that was commenced immediately upon issuance of the PCAOB Order. Had the Commission reviewed the PCAOB Order through its plenary review authority granted by 15 U.S.C.A. § 7217(c)(3), at a minimum the Hall Respondents would have been entitled to a hearing and an opportunity to present evidence why the PCAOB Order should affirmed, modified or set aside. 15 U.S.C.A. 78s(e)(1). Now through the Division's Motion, the Division seeks to deny the Hall Respondents even that hearing. If this administrative court rejects the Hall Defendants' argument that *res judicata* bars the additional sanctions sought herein, at a bare minimum, the Hall Defendants should be given an evidentiary hearing to present evidence on the issues of willfulness, alleged lack of remorse or recalcitrance, likelihood of future violations, the severity of proposed sanctions, proper methods of counting alleged number of violations and all other issues going to the appropriate sanctions.

[11] See n.10 *supra.*

3. The Penalties Sought Have No Rational Basis

The penalties sought by the Commission bear no rational relation to its goal of enforcing the securities laws. "If the civil sanction 'cannot fairly be said solely to serve a remedial purpose, but rather can be explained only as also serving either retributive or deterrent purposes,' then the sanction constitutes punishment and implicates the Double Jeopardy Clause." *United States v. Reed*, 937 F.2d 575, 577-78 (11th Cir. 1991) (citing *United States v. Halper*, 490 U.S. 435, 448 (1989)). "Where the civil sanction at issue is money damages imposed pursuant to a statutory provision, we are to look to the size of the award to determine whether it is rationally related to the remedial goal of compensating the government for its loss." *Id.* The penalties being asserted by the Commission constitute a second punishment for claims arising from the same nucleus of fact and are not rationally related to the remedial goal of enforcing securities laws. It is significant that the Division does not allege that as to any of the audit or review engagements, any of the financial statements that were reviewed and audited contained any misstatement or omission of material financial information. All of the allegations are based solely on failure of the Hall Group to meet independence or EQR requirements of the PCAOB rules and regulations. No company and no investor are alleged to have suffered any actual financial harm whatsoever. The Division's request for the extreme financial penalties against Mr. Hall and the firm in addition to the penalties already suffered by virtue of the PCAOB Order serves no public interest and merely seeks retributive and penal sanctions.

The sought after cease and desist order also has no rational basis. In consenting to the PCAOB Order, the Hall Respondents have already agreed not to perform public company accounting functions, the Hall Group has agreed to have its registration with the PCAOB revoked and Mr. Hall has been barred by Sarbanes-Oxley from serving any public company in an

accounting or financial management capacity. To justify a cease and desist order the prospect of future violations need not be great, but it cannot be nil. *See* Steadman Factors cited by the Division's Motion at 13. Here, given the orders already entered by the PCAOB the likelihood of that the Hall Respondents occupation will present opportunities for engaging in future accounting, financial management or auditing violations with respect to public companies is non-existent.

It is difficult to comprehend how the Division in good conscience can allege that the Hall Respondents have offered no assurances against future violations, expressed no remorse and accepted no responsibility for their conduct. *See* Division's Motion at 14. The Hall Respondents voluntarily entered into a settlement with the PCAOB, the Hall Group surrendered its registration with the PCAOB, and Mr. Hall agreed not to serve as a public company accountant or financial manager and paid a monetary fine. Even the Hall Respondents' answer in this matter, cited to liberally in the Division's Motion, does not deny many of the wrongful acts attributed to them by the OIP. See paragraphs Hall Response at ¶¶2, 19, 21, 22, 27, 28 referenced by the Division's Motion at 2, 3, 4, 5, 7, 8, 9, 12, and 18. The Division argues that the Hall Group's conduct was willful and that Mr. Hall willfully aided and abetted the various alleged violations. Nearly all of the Division's asserted violations occurred during the time frame after July 2013 when Respondent Michelle Helterbran Cochran terminated her employment with the Hall Group. Her departure left no partner level employee of the Hall Group. The Hall Group was unable to remedy timely the exigent circumstances of Mr. Helterbran Cochran's departure which resulted in the unintended rule violations. While the rules were technically violated, the violations were not intentional or willful and the Division does not claim that they caused actual investor harm. As discussed above, the Hall Respondents should be provided an opportunity to present all facts

relating to their efforts to replace Ms. Helterbran Cochran to avoid the rule violations alleged herein and all other facts outlined above constituting mitigating factors of the requested sanctions. *Cf., In re Gately & Assoc.*, Rel. No. 62656, 2010 WL 3071900 (August 5, 2010) (holding that the Commission should be "particularly careful to address potentially mitigating factors"), citing *Paz Sec., Inc.*, Exchange Act Rel. No. 57656 (Apr. 11, 2008) and *Steadman v. SEC*, 603 F.2d 1126, 1137-40 (5th Cir. 1979).

CONCLUSION

The SEC was fully aware of the nature and ramifications of the PCAOB proceedings, had the opportunity through its wholly-controlled sub-agency, the PCAOB, to present evidence and testimony, and had access to develop fully the evidentiary record. In fact, the SEC's OIP was entered the very same day as the PCAOB Order (April 26, 2016). The claims asserted in the OIP arose out of the *same nucleus of facts* as the PCAOB Order and are related in time, space, origin, and motivation. Consent to further litigation was not expressly reserved by the PCAOB or the SEC. The PCAOB's decision in the former litigation precludes this disciplinary action before the SEC under claim preclusion. The Division's Motion for Partial Summary Judgment should therefore be denied.

Dated: July 22, 2016

Respectfully Submitted,

JONES & KELLER, P.C.

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CERTIFICATE OF SERVICE

I hereby certify that on this 20th day of July, 2016, a true and correct copy of the foregoing HALL RESPONDENTS' BRIEF IN OPPOSITION TO THE DIVISION OF ENFORCEMENT'S MOTION FOR PARTIAL SUMMARY DISPOSITION was served on the following as indicated:

Via Regular U.S. Mail (Original & 3 copies) to:

US Securities & Exchange Commission
Attn: Brent J. Fields, Secretary
Office of the Secretary
100 F. Street NE, Mail Stop 1090
Washington, DC 20549
evanstim@sec.gov
WhippleDa@SEC.GOV

Via Email to:

The Honorable Cameron Elliot
Administrative Law Judge
Securities & Exchange Commission
alj@sec.gov

Via Regular Mail and Email:

Michele Helterbran Cochran
[redacted]

Via Regular Mail and Email:

Susan A. Cisneros
[redacted]

s/ Tammy Harris
Tammy Harris