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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17387

In the Matter of

DONALD F. ("JAY") LATHEN, JR.,
EDEN ARC CAPITAL
MANAGEMENT, LLC,
and EDEN ARC CAPITAL
ADVISORS, LLC

Respondents.

DIVISION OF ENFORCEMENT'S PREHEARING BRIEF

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PRELIMINARY STATEMENT

Respondents perpetrated a scheme to buy bonds at a discount and then put them back to issuers at full face value for a quick profit. But for the scheme to work, Respondents had to materially misrepresent the ownership of the bonds. And so they did, profitably for many years, in violation of the anti-fraud provisions of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act"). Along the way, they demonstrated further contempt for the securities laws, violating the Custody Rule promulgated under the Investment Advisers Act of 1940 ("Advisers Act").

Respondent Donald Lathen is the managing member of Eden Arc Capital Management, LLC, a formerly-registered investment adviser, and Eden Arc Capital Advisors, LLC. Eden Arc Capital Management in turn advises, and Eden Arc Capital Advisors is the general partner to, Eden Arc Capital Partners, LP, a hedge fund with a singular investment strategy—to invest in "survivor's option" instruments. A survivor's option is a feature in many retail bonds that allows surviving family members of a deceased bond owner to redeem the bond at par at the time of the owner's death, instead of waiting until the bond matures, sometimes years away.

As Respondents knew (or recklessly disregarded), survivor's option bonds also held an opportunity for sophisticated investors. Because these bonds frequently trade in the secondary market below par, being able to redeem them prior to maturity allows an investor who, for example, buys them for $97 in the secondary market, to earn a $3 per bond spread by exercising the survivor's option. But survivor's options cannot be exercised by a fund (which cannot die or "survive" someone who does). So, as Respondents knew, or recklessly disregarded, to take advantage of the survivor's option, and capture the spread between the market price and par, they needed to create the appearance that two human beings jointly owned the bonds. In reality, Lathen and especially the Participants—terminally ill individuals whom Lathen paid for the use of their names on the requisite brokerage accounts—merely acted as "straw men" for Respondents' hedge fund, allowing it to take advantage of a survivor's option that would not otherwise be available to it. Both Lathen and the Participants signed away ownership rights over the bonds in favor of Respondent's hedge fund (which had paid for the bonds in the first place).

Respondents knew (or recklessly disregarded) that if the issuers ever found out the truth about their ownership arrangement, they would likely dispute the validity of Respondents' redemption requests. Lathen repeatedly flagged this risk—that the issuers might refuse to redeem the bonds if they learned the truth—telling one investor, "I think the consensus has been that the strategy should work for some period of time until it doesn't, in which case the trade will have played out." In other words, Respondents would be able to continue to redeem bonds so long as Lathen was able to keep the issuers from learning that he and the Participants had signed away their ownership rights. Lathen was correct; Respondents' scheme misled the bond issuers. And, when they learned the truth, many of them refused to redeem, just as Lathen had predicted.

By representing himself and the Participants as joint owners—without also disclosing the many caveats to that "ownership"—Respondents misled issuers into believing that the ownership structure was different from what it was. Respondents, therefore, materially misled the issuers and, as was their plan all along, deprived the issuers of the ability to make an informed decision as to whether Lathen was an eligible redeemer. This is securities fraud, plain and simple.

CONTENTIONS OF FACT

A. Respondents

Donald F. ("Jay") Lathen, Jr., is the Chief Executive Officer, Chief Compliance Officer, Chief Financial Officer, Chief Investment Officer, managing member, and founder of Eden Arc Capital Management, LLC. Prior to founding Eden Arc Capital Management, Lathen had 15 years of investment banking experience, including at Citigroup and at Lehman Brothers.

Eden Arc Capital Management, LLC ("EACM" or "Eden Arc Adviser"), is an investment adviser, registered with the Commission between 2012 and 2016, which was founded and controlled by Lathen. EACM acted as the investment manager to Eden Arc Capital Partners, LP. Besides Lathen, EACM had only one employee.

Eden Arc Capital Advisors, LLC ("EACA"), is the general partner of Eden Arc Capital Partners, LP. Lathen is EACA's managing member and sole owner.

B. Other Relevant Parties

Eden Arc Capital Partners, LP (the "Fund"), is a hedge fund established by Lathen in approximately 2011. The limited partners in the Fund paid varying fees: (1) annual performance fees ranging from 16% to 30% of profits to the general partner, EACA; and (2) annual management fees ranging from 0.5% to 2% of assets under management to the Eden Arc Adviser.

C. The Initial Scheme

Respondents established the Fund in 2011. Their investment strategy was to buy instruments (bonds and Certificates of Deposit ("CDs"))[1] that contained a survivor's option ("SO"). When the bonds were jointly owned, this option allowed the investments to be redeemed upon the death of a joint beneficial owner, at par value, by the surviving joint beneficial owner. Respondents' sole investment strategy involved purchasing SO instruments on the secondary market at a discount and then putting them back to issuers pursuant to the SO provision.

But, to execute that strategy, Respondents needed two people to jointly own the bonds, and one of them had to be likely to die in the near future. As Respondents knew, the SO was only available to individuals, not entities. This is because, in Lathen's own words, "an entity can't perish." Thus, at redemption, Respondents needed to convince issuers that the SO bonds had been

[1] Respondents' CD redemptions are not at issue in this case.

owned – not by a hedge fund – but by two human beings: (1) a Participant, who by dying created the redemption right; and (2) a "joint owner," a surviving human who would be able to cash in that redemption right.

To create the appearance of human ownership and capitalize on the early redemption rights provided by the SO, Respondents did two things. First, they canvassed hospices and social workers to identify terminally-ill Participants who were medically certified as having less than six months to live. Respondents paid the terminally-ill patients $10,000 for the right to use their names to open up purported "joint tenancy with the right of survivorship," or "JTWROS," accounts (the "Accounts") at various broker-dealers.

Second, Respondents listed Lathen on the Accounts as a "joint owner." When a Participant died, Lathen sent a Redemption Exercise Letter to the issuers (or their trustees) stating, for example:

> [The Participant], a joint owner[2] on the above-referenced account, recently passed away. As the surviving joint owner on the account, I would like to exercise the survivor's option with respect to the following Notes in the account.

However, Respondents omitted from their letters the crucial fact that both Lathen and the Participant had both already explicitly disclaimed their respective ownership over the assets in the Accounts.

1. *The Participants Disclaimed Their Ownership Interests in the Bonds*

While Lathen wanted the Participants to look to the issuers as if they had a beneficial ownership interest in the bonds, in reality, to protect the Fund investors' money, Lathen had to make sure that the Participants had no real control over the assets in the joint Accounts. To ensure

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2 Other Redemption Exercise Letters describe the Participant as a "joint and beneficial owner" on the Account.

that the Participants or their estates did not lay claim to the SO investments, Lathen had the Participants enter into Participant Agreements and sign Powers of Attorney before opening up the Account in their names. These Agreements stripped the Participants of all but the most theoretical ownership rights and responsibilities, and ensured that only Lathen had any access to the Account funds and securities. Thus, even before Lathen opened the Accounts in the Participants' names, under the Participant Agreements, the Participants had already disavowed any interest in, or control over, the Accounts' assets:

- "Participant agrees that he/she is not permitted to pledge, borrow against, or withdraw fund from the Account(s) without the express written permission of Lathen, which permission may be withheld in Lathen's sole discretion";
- Lathen had the authority to transfer "cash and securities into and out of the Account(s) without [the Participants'] prior consent, including to and from other accounts that Lathen and the Investors control"; and
- "Lathen and Investors are solely responsible for funding the Account(s), including funding the purchase of any securities transferred into the Account(s) or subsequently purchased in or from the Account(s). Participant shall have absolutely no responsibility for funding the Account(s) and the Participant affirms that no such consideration has been provided to or by Participant for such purpose."

And, Participants were required to acknowledge in the Agreements that, upon the Participant's death, "all assets and proceeds from such Account(s) will pass directly to Lathen and the Investors."

Under the Powers of Attorney, the Participants agreed that Lathen and the Eden Arc Adviser could, without ever consulting the Participant:

- Open the brokerage account;
- Manage and handle the brokerage account in every material respect;
- Purchase and sell securities in any way they saw fit;
- Execute agreements on behalf of the Participants; and

- Transfer funds and securities into and out of the Accounts as they saw fit.

Thus, in reality, Participants signed away any right to the Accounts before they were ever opened. Indeed, most Participants did not even open the Accounts, or know where or when they had been opened; Lathen executed account opening documents, signing their names as agent, using the powers granted to him by the Powers of Attorney.

To allay any concerns about the Participants absconding with their investments, Respondents assured investors in the Fund that Participants would not be able to access the Accounts. Consistent with this representation, Lathen took other steps to ensure that the Participants could have no access to, or ability to control, any of the assets in the JTWROS Accounts, in addition to the restrictions in the Participant Agreements. For example:

- Broker-dealers were instructed not to send account statements to the Participants;
- Investors were assured that Participants were not given information about "any details" of the Accounts, including the brokerage firm or the account number;
- The JTWROS Accounts were set up as "two-signature accounts," meaning that Lathen could withdraw or transfer funds and securities at will with the Participants' Powers of Attorney, but the Participants could not access the Accounts without Lathen's explicit approval; and
- If a Participant tried to access the Account, Lathen could simply move the assets in it to another account by virtue of the Powers of Attorney.

Further demonstrating the Participants' lack of interest in the Accounts, Lathen transferred securities among various Accounts—without providing any notice to the Participants (his purported "joint owners")—in order (1) to place securities in an Account in the name of a Participant whose health was quickly declining, or (2) to move securities away from a Participant who was recovering.

Lathen well understood (having designed the investment strategy) that the Participants had no real interest in the Accounts. As he told an investor, in response to the question "[h]ow do you keep the family from having a claim to the asset during the life of the joint owner?":

> Answer: My participant contract explicitly spells out their profit share in the account, subject to minimum and maximum amounts. It also prevents the family from making withdrawals from the account without my consent. Attached to the Participant agreement is a limited POA whereby they grant authority to me to establish and manage the account. The Limited POA and the participant agreement explicitly authorize me to move cash and securities into and out of the joint account. Most of the time the participant doesn't even know where the account will be opened. Finally, the brokerage firm requires all account holders' signatures to move funds out of the account so even if they found out where the account was carried and called the brokerage firm to attempt a withdrawal, they wouldn't be successful. So far no participant has requested additional funds from the account either through me or from the brokerage. They are delighted to receive the money up front and I don't usually hear back from the family until the death of the participant.

Respondents further acted as if the Participants had no ownership interests in the Accounts by: (1) not providing Participants with Form 1099s for amounts earned in the Accounts; and (2) telling at least one governmental social services entity, who subpoenaed information about the JWTROS Accounts, that the Participant received a one-time payment and will receive no further payment now or in the future.

2. ***Lathen Likewise Disclaimed His Ownership Interest in the Bonds***

In May 2011, Lathen entered into an Investment Management Agreement with the Fund and the Eden Arc Adviser. Under that Agreement, Lathen explicitly gave up his own ownership interest in the bonds held in the Accounts, stating that:

- Lathen will hold the SO investments, and all right, title and interest therein and benefit to be derived therefrom, as nominee for and on behalf of the Fund only;
- Lathen has no legal or beneficial interest in the SO investments; and

- All other attributes of the beneficial ownership of the SO investments remain with the Fund.[3]

3. Respondents Solicited Investors for the Fund

At its peak, the Fund had about $52 million in total assets and 22 investors, including the general partner. In their communications with investors, Respondents consistently presented the Fund as investing in the bonds. For example, they told investors that the Fund's investment strategy was to acquire the SO investments in the Accounts managed by nominees and that the Fund would hold those instruments until such time as the Fund was able to redeem the bonds as a result of the death of the Participant.

D. Respondents Knew (or Recklessly Disregarded) That Their Redemption Exercise Letters Would Mislead the Issuers

Lathen understood that his statements concerning his and the Participants' ownership in the Accounts misled the bond issuers. While telling investors in the Fund that that he had no ownership interest—beneficial or otherwise—in the assets in the Accounts, he told the issuers just the opposite. And while telling the issuers that a "joint owner" or "joint and beneficial owner" of the Account had died, he knew that the Participants had explicitly signed away their rights to the securities in the Accounts both during and after their lifetimes.

Lathen also understood that his redemption rights might be disputed by the issuers if they learned that neither the Participant nor Lathen had any beneficial ownership rights. First, many of the bond prospectuses required proof that the deceased was the "beneficial owner" of the bond at the time of death an explicit requirement to redeem. For example:

3 Lathen sometimes added a third person (his stepfather or his wife) as an additional joint tenant on the Accounts, as an added layer of protection, so that in the event of Lathen's death, the funds and assets in the Accounts would never flow to the unwitting Participant. But the Investment Management Agreement made clear that Lathen's stepfather likewise had no ownership rights over the Accounts' assets.

> The "Survivor's Option" is a provision in a note pursuant to which we agree to repay that note, if requested by the authorized representative of the beneficial owner of that note, following the death of the beneficial owner of the note, so long as the note was owned by that beneficial owner or the estate of that beneficial owner at least six months prior to the request.
>
> [. . .]
>
> The death of a person holding a beneficial ownership interest in a note as a joint tenant . . . will be deemed the death of a beneficial owner of that note . . . .
>
> [. . .]
>
> The death of a person who, during his or her lifetime, was entitled to substantially all of the beneficial ownership interests in a note will be deemed the death of the beneficial owner of that note for purposes of the Survivor's Option, regardless of whether that beneficial owner was the registered holder of that note . . . .
>
> [. . .]
>
> To obtain repayment pursuant to exercise of the Survivor's Option for a note, the deceased beneficial owner's authorized representative must provide . . . appropriate evidence satisfactory to the trustee and us . . . that the deceased was the beneficial owner of the note at the time of death . . . .

Lathen was an expert on survivor's options in bonds. He knew that issuers included the survivor's option in order to entice retail investors—"mom and pops" as he called them—and not to allow investment funds to take advantage of the imminent death of someone who had signed away any ownership rights even before a bond was purchased, purportedly in their name, or transferred to an account in their name. Lathen also knew that the SO bond offering documents provided that the decision to redeem bonds, pursuant to an exercise of the SO, lay with the issuers and/or their trustees.

Importantly, Lathen understood that the issuers and trustees—if given enough information to understand his scheme—might not agree that his novel (but undisclosed) investment strategy qualified Respondents to redeem bonds pursuant to the SO. Indeed, he repeatedly warned his investors both of the risk that the issuers would discover the true nature of his investment strategy and the need to hide it. Labelling this a "RISK ASSOCIATED WITH THE PARTNERSHIP'S INVESTMENT STRATEGY," Respondents candidly admitted to their investors that issuers might reject their strategy of buying bonds in the names of nominee Participants if the issuers understood all the facts:

> **Posture of Issuers, Trustees and Brokerage Firms toward the Investment Strategy**
>
> The prospectus for a particular SO Investment contains the guidelines, procedures and limitations which apply to the exercise of the survivor's option feature for a particular issuer and issue. It is unclear whether any of the issuers of the SO Investments ever contemplated the Partnership's investment strategy when they drafted their prospectuses. While the General Partner believes that its strategy conforms with the prospectus guidelines and represents a valid survivor's option redemption, there is a possibility that issuers and trustees may take a contrary view. If so, the Partnership could incur legal expenses to force issuers and trustees to redeem the SO Investments . . . The Partnership could also be exposed to an adverse judgment in favor of the issuers which might preclude or severely limit the ability of the Partnership to successfully redeem it[s] SO investments on an ongoing basis.
>
> [. . .]
>
> Because of the nature of the Partnership's investment strategy, there is a risk that the Partnership could receive unflattering media attention. Such exposure increases the likelihood that the Partnership's investment strategy could undergo greater scrutiny by issuers, trustees, brokerage firms and others. This could have an adverse impact on the Partnership.

Thus, Lathen well understood that (1) withholding information about his ownership structure would mislead the issuers; and (2) misleading the issuers was critical to the success of his business.[4]

E. The Issuers Were Misled

When certain issuers learned of Respondents' scheme, they did exactly as Respondents had feared. They refused to redeem, telling Lathen on a number of occasions that the Participants were neither beneficial, nor bona fide, owners of the bonds. Moreover, certain of the issuers who, upon learning the truth, rejected Lathen's redemption requests also rejected the reasoning Respondents have now put forward in this proceeding that there was a valid joint tenancy with right of survivorship under New York State law.

Despite knowing that certain issuers rejected their ownership claims, Respondents continued to submit the Redemption Exercise Letters discussed in Section A supra, without notifying the issuers of the true nature of Lathen's and the Participants' purported ownership rights.

F. Respondents Also Falsely Completed Account Opening Documents in Carrying out Their Scheme

In account opening applications Lathen signed to open some of the Accounts, he falsely represented that each of Lathen and the Participants:

> shall have the authority on behalf of the joint account to buy, sell . . . and otherwise deal in, through you as broker, stock, bonds and other securities and commodities . . . to receive on behalf of the joint account demands, notices, confirmation, reports, statements of

[4] Notwithstanding Lathen's long recognition that truthful disclosure would cause issuers and trustees to challenge his redemptions, he appears to have raised the issue with none of the lawyers he consulted about the joint tenancies. Rather, lawyers he consulted appear to have gratuitously warned him of the need to make a full disclosure to all "third parties," and that his investment scheme would raise "disclosure issues" with issuers and regulators—advice he appears to have ignored.

> account and communications of every kind; to receive on behalf of the joint account money, securities and property of every kind and to dispose of the same; to make on behalf of the joint account agreements relating to any of the foregoing matters and to terminate or modify same or waive any of the provisions thereof and generally to deal with you or [the clearing broker] on behalf of the joint account as fully and completely as if he alone was interest in said account.

For all the reasons discussed above, Lathen understood that the Participants did not, in truth, have the right (or ability) to take any of the actions described in these agreements.

G. Respondents Altered Certain Features of Their Purported Ownership Structure

In late 2012, Respondents were advised that the Investment Management Agreement structure—by which Lathen disclaimed all ownership in the bonds—would not work to create valid joint tenancies since the real owner of the securities in the joint accounts would be the Fund—an entity. Accordingly, in early 2013, Rèspondents did away with the Investment Management Agreement for new accounts they set up, and adopted new "loan" and "profit sharing" agreements that created the appearance that the Fund was (1) lending money to Lathen to purchase the bonds in the Accounts, instead of funding the purchase outright; and (2) Lathen was assigning all of the profit or losses from the Accounts back to the Fund.[5] These new agreements purported to change the relationship among the parties to that of lender (the Fund) and borrowers (Lathen and, later, the Participants).[6]

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[5] Accounts opened prior to the execution of the Profit Sharing Agreement in January 2013—at least 25—were explicitly still governed by the Investment Management Agreement. Respondents continued to redeem securities held in those Accounts through 2014, even after Lathen was advised that the joint tenancies which held them were invalid. Those Accounts were open and at least one held securities into 2016, in violation of the Custody Rule, as well. See Contentions of Law Section B, infra.

[6] Not until 2015 did Lathen change the lending agreements to also sign them on behalf of the Participants.

However, even under this new arrangement, the same restrictions applied to the Participants' and Lathen's enjoyment of (or ability to buy, sell, or pledge) the bonds. In reality, as Respondents told their investors, the Fund's money was deposited into the Accounts and used to acquire SO investments and the Fund was entitled to receive all of the profits and/or losses from the Accounts. Moreover, the Fund's profits were in no way affected because the Profit Sharing Agreement declared that the income and losses from the Accounts would still be treated as belonging to the Fund for federal income tax purposes.

Changes during this period to the Participant Agreement were similarly superficial. Although Respondents removed the explicit language limiting a Participant's right to pledge, borrow against, withdraw or otherwise exercise ownership rights, such restrictions were still in place—a fact Lathen conveyed to investors. Thus, for example, Participants were still required to sign a Power of Attorney prior to the opening of the brokerage Accounts, which assigned to Lathen all right and power to move funds in and out at will, while the Participants could not do anything with respect to the Accounts unless they had the prior authorization of Lathen.

Later Participant Agreements provided that Participants might be entitled to a maximum of 5% of the net profits in the Account, but even that created no real interest because each Participant was forced to expressly acknowledge that there was no assurance that he/she or his/her estate would receive additional payments under the Agreement.[7] In fact, no Participant ever received more than the $10,000 up-front payment. Indeed, one iteration of the Participant Agreement memorializes that even in the unlikely event that Lathen predeceased a Participant, "it is unlikely that Participant or Participant's estate will receive any distributions from the Account(s) upon the death of Lathen," because of the Fund's liens on the Accounts.

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7 The provision that Participants may be entitled to a maximum of 5% of the net profits in the Account was removed from still later iterations of the Participant Agreements.

After this change in structure, Lathen continued to furnish the issuers with misleading confirmations of the Participants' alleged "joint ownership" or "joint and beneficial ownership" of the bonds, and his status as alleged surviving "joint" owner, statements that misstated or omitted material information about the true story of the beneficial ownership of the bonds. Thus, Respondents' representations to the issuers about Lathen's and the Participants' "ownership" of the bonds remained, at a minimum, misleading. Indeed, as discussed in Contentions of Fact Section E, supra, a number of these issuers refused to redeem bonds under Respondents' updated arrangement because Lathen's Redemption Exercise Letter did not accurately (in their view) disclose that the Participants were not "beneficial owners," as they needed to be to make Lathen's redemption eligible for payment.

CONTENTIONS OF LAW

A. Respondents Violated the Antifraud Provisions of the Securities Act and Exchange Act

To establish violations of the antifraud provisions of the Exchange Act and the Securities Act, the Division must demonstrate that Respondents (1) made a material false or misleading statement, or used a fraudulent device; (2) with scienter, or, in the case of Securities Act Sections 17(a)(2) and (a)(3), negligence; (3) in connection with the purchase, sale, or offer of securities. See SEC v. Monarch Funding Corp., 192 F.3d 295, 308 (2d Cir. 1999); see also SEC v. Goldman Sachs & Co., 790 F. Supp. 2d 147, 164 (S.D.N.Y. 2011) (holding "actual sales [are] not essential" for a Securities Act Section 17(a) claim).

1. Respondents Made False and Misleading Statements

Respondents' statements to the issuers that Lathen and the Participants were the owners of the bonds were, at least, highly misleading. As well as outright falsehoods, Exchange Act Section 10(b) and Securities Act Section 17(a) also prohibit "half-truths—literally true statements that create a materially misleading impression." SEC v. Gabelli, 653 F.3d 49, 57 (2d Cir. 2011), rev'd on other grounds, Gabelli v. SEC, 133 S. Ct. 1216 (2013). Whether a statement is misleading is judged from the point of view of a hypothetical objective investor. See Omnicare, Inc. v. Laborers Dist. Counsel Const. Indus. Pension Fund, 135 S. Ct. 1318, 1327 (2015) ("whether a statement is 'misleading' depends on the perspective of a reasonable investor. The inquiry (like the one into materiality) is objective.").[8]

Here, there is ample evidence from which to conclude that the statements—which falsely claimed ownership and omitted to disclose the many caveats to Lathen's and the Participants' purported ownership—were misleading: (1) Lathen's statements to the issuers were directly contradicted by the statements in Respondents' agreements, including in the Participant Agreement and the Investment Management Agreement, as well as Respondents' disclosures to the Fund's investors; (2) Respondents withheld from the issuers these side agreements that (if disclosed) would have notified the issuer of the substantial questions as to the validity of the Respondents' redemption rights; (3) Respondents flagged for their investors that the issuers might take issue with Lathen's statements (and still hid the truth from the issuers); and (4) when they learned the truth of Respondents' ownership scheme, many of the issuers refused to redeem the bonds. (See Contentions of Fact, supra.)

Courts find that the failure to disclose side agreements that impact a defendant's public statements is materially misleading. See, e.g., In re Bristol Myers Squibb Co. Secs. Litig., 586 F. Supp. 2d 148, 167 (S.D.N.Y. 2008) (finding a cognizable claim where defendants failed to disclose secret oral side agreements concerning the terms of a litigation settlement); In re Livent, Inc.

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8 For Rule 10b-5 purposes, the "maker" of a false statement is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." Janus Capital Grp., Inc. v. First Derivative Traders, 564 U.S. 135, 142 (2011). Here, Lathen signed the fraudulent Redemption Exercise Letters.

Noteholders Secs. Litig., 355 F. Supp. 2d 722, 732 (S.D.N.Y. 2005) (predicating summary judgment for the plaintiffs on, among other things, failure to disclose side agreements); see also Hughes v. Huron Consulting Grp., Inc., 733 F. Supp. 2d 943, 948 (N.D. Ill. 2010) (finding that claims of undisclosed side agreements were cognizable and noting that "[i]t would be a remarkable coincidence indeed if the very agreements that undermined defendants' favorable accounting treatment were the items defendants innocently omitted from review by. . . auditors."); Schultz v. Tomotherapy Inc., 08 Civ. 314, 2009 WL 2032372, at *15 (W.D. Wisc. July 9, 2009) (plaintiffs stated a claim where defendants disclosed that orders may be cancelable, but did not disclose side agreement that increased the likelihood and costs of such cancelations). For example, in Intermodal Cargo Servs., Inc. v. Am. Indus. Ltd., the court found that—even where the withheld agreement was, in fact, "ineffective to vary or modify the terms" of the disclosed agreement—defendant's failure to disclose it to investors was nonetheless a fraudulent "material omission or misrepresentation" because it demonstrated defendant's company's "lack of capacity and intent to perform the apparent terms of its only contract . . . ." 79 Civ. 3812, 1982 WL 1397, at *4 (N.D. Cal. Dec. 3, 1982). So it is here, where Respondents purposefully withheld information from the issuers that they knew materially affected the issuers' understanding (and ability to evaluate) Respondents' redemption claims. See also City of Roseville Emps. Retirement Sys. v. EnergySolutions, Inc., 814 F. Supp. 2d 395, 410 (S.D.N.Y. 2011) (upholding fraud claim where issuer disclosed certain information about their business contracts, but omitted information showing that it was "highly unlikely" that the contracts would be as valuable as represented); In re Sterling Foster & Co. Secs. Litig., 222 F. Supp. 2d 216, 263-64, 279 (E.D.N.Y. 2002) (complaint sufficiently pled fraud where plaintiffs alleged that defendant's prospectus "should have disclosed

. . . secret agreement between various" securities holders and defendant, which may have affected the price of securities and, thus, would have been material to plaintiffs' decisions to purchase).[9]

2. *Respondents' False and Misleading Statements Were Material*

Misleading statements are considered material if "there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information available." SEC v. DiBella, 587 F.3d 553, 565 (2d Cir. 2009) (citation and quotation marks omitted). Materiality is generally a "mixed question of law and fact." SEC v. Mayhew, 121 F.3d 44, 51 (2d Cir. 1997).

Here, the materiality of the many caveats and restrictions on Lathen's and the Participants' purported ownership of the bonds is plain: (1) Lathen warned his investors that the issuers might care about the information; (2) when issuers learned of the information, they complained to Lathen about withholding it and, indeed, many refused to redeem the bonds; and (3) even after Lathen learned that many of the issuers wanted to know the full truth—and had ceased redemptions when they learned it—he continued to hide it from other issuers in the hopes that they would continue redeeming.

3. *Respondents Acted with Scienter*

Scienter, which the Division must establish under Exchange Act Section 10(b) and Securities Act Section 17(a)(1), is a mental state embracing an intent to deceive, manipulate, or defraud. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). Either knowing misconduct or reckless disregard for the truth will establish scienter. Novak v. Kasaks, 216 F.3d 300, 308 (2d

[9] With respect to those redemptions made for Accounts governed by the Investment Management Agreement, the statements in the Redemption Exercise Letters were materially false or misleading because, contrary to the statements Lathen made in those Letters about his ownership of the Accounts, he explicitly disavowed such ownership in the Investment Management Agreement.

Cir. 2000). The Division can demonstrate recklessness by showing that Respondents' conduct presented a "danger [of misleading] . . . that was either known to the defendant or so obvious that the defendant must have been aware of it." Id.; accord In the Matter of Joseph P. Doxey, Rel. No. 33-10077, 2014 WL 2593988, at *2 (S.E.C. May 5, 2016).

Here, Respondents acted with the requisite scienter. They understood the true nature of their ownership structure, understood that the issuers might dispute that ownership, and made a decision to withhold the relevant information concerning the caveats on Lathen's and the Participants' ownership rights. Thus, when Respondents told the issuers that Lathen and the Participants were the "owners" of the bonds eligible for redemption, they consciously withheld material information necessary to allow the issuers to evaluate that claim.

Respondents' appreciation of the materiality of the information they were withholding from the issuers is underscored by their own actions. As discussed more fully below, Respondents recognized that issuers might challenge the validity of the joint tenancies, and repeatedly sought to obtain opinions from law firms to shore up their position. In seeking those opinions, Respondents appear to have provided their lawyers with the full documentation of the Accounts, including the Participant Agreements and Powers of Attorney, demonstrating that they understood that those documents would be necessary to determine whether the joint tenancies were valid, and thus whether the redemptions were eligible.

Respondents were much less forthcoming with the issuers. While purporting to be "an open book," Lathen rebuffed issuer/trustee requests for more information about the Accounts, maintaining that that information was not necessary or required.

4. Respondents Were Also Negligent in Failing to Disclose the Truth to the Issuers

Sections 17(a)(2) and (3) of the Securities Act require only that Respondents acted negligently. Negligence is "[t]he omission to do something which a reasonable man . . . would do . . . ." Black's Law Dictionary, 1032 (6th ed. 1991). The Commission has held that evidence sufficient to demonstrate scienter will also establish negligence for purpose of Securities Act Section 17(a)(2)-(3). See, e.g., In the Matter of Anthony Fields, Rel. No. IA-4028, 2015 WL 728005, at *14 (S.E.C. Feb. 20, 2015) (finding that respondent "acted with scienter" and, as a result of the same conduct, "willfully violated" Section 17(a)(3)); In the Matter of Johnny Clifton, Rel. No. 33-9417, 2013 WL 3487076, at *10 n.67 (S.E.C. July 12, 2013) ("[B]ecause the evidence establishes that [Respondent] acted with scienter, a negligence analysis [under Section 17(a)(3)] is unnecessary.) Indeed, the Commission has held that where, as here, a respondent prevented a counterparty from learning material information about the offer or sale of securities, the Division has made out a Section 17(a)(3) violation. See In the Matter of Dennis J. Malouf, Rel. No. IA-4463, 2016 WL 4035575, at *12 (S.E.C. July 27, 2016) ("Section 17(a)(3)'s prohibition thus applies, for example, where, as a result of a defendant's negligent conduct, investors receive misleading information about the nature of an investment or an issuer's financial condition. It also applies, for example, where, as a result of a defendant's negligent conduct, prospective investors are prevented from learning material information about a securities offering."), order corrected on other grounds, Rel. No. 33-10207, 2016 WL 4761084 (S.E.C. Sept. 13, 2016). Thus, for all the reasons set out above with respect to Exchange Act Section 10(b) and Securities Act Section 17(a)(1), Respondents violated Securities Act Sections 17(a)(2)-(3).

5. *Respondents' Fraud Was in Connection with the Purchase or Sale, and in the Offer, of Securities*

The Section 10(b) "in connection with" requirement is given a "broad interpretation," Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 85 (2006), requiring only that the false statement or omission at issue "somehow touches upon or has some nexus with any securities transaction." SEC v. Stanard, 06 Civ. 7736 (GEL), 2009 WL 196023, at *27 (S.D.N.Y. Jan. 27, 2009) (internal quotation omitted). The same broad interpretation applies to Section 17(a)'s requirement that the fraud be "in the offer or sale" of a security. United States v. Naftalin, 441 U.S. 768, 773 (1979) ("The statutory terms, which Congress expressly intended to define broadly . . . are expansive enough to encompass the entire selling process"). Courts hold that redeeming securities—in other words selling the securities back to the issuer—satisfies the "in connection with the purchase or sale" and "in the offer or sale" elements. See, e.g., Drachman v. Harvey, 453 F.2d 722, 737& n.2 (2d Cir. 1971) (en banc) (finding that redemption of a convertible debenture satisfied the "in connection with" requirement); Marcus v. Quattrocchi, 08 Civ. 9514 (VB), 2014 WL 521340, at *14 (S.D.N.Y. Feb. 4, 2014) (finding that redeeming securities can satisfy the "in connection with" requirement); SEC v. Wealth Strategies Partners, LC, 14 Civ. 02427 (TGW), 2015 WL 3603621, at *7 (M.D. Fla. June 5, 2012) (redemptions satisfy the "in connection with" and "in the offer or sale" elements). Here, there can be no question that bonds, which were registered with the Commission, were securities, and their redemption by the issuer constitutes a "sale" of the note back to the issuer.

B. EACM Violated Advisers Act Section 206(4) and Rule 206(4)-2 Thereunder

Section 206(4) of the Advisers Act provides that it shall be unlawful for any investment adviser to "engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative." Rule 206(4)-2 specifies that it is a "fraudulent, deceptive, or manipulative act, practice or course of business" for a registered investment adviser to have custody of "client funds or securities" unless the adviser complies with certain specified requirements. See 17 C.F.R. § 275.206(4)-2. Among those requirements are that client funds and securities are held either "(i) [i]n a separate account for each client under that client's name; or (ii) [i]n accounts that contain only [the investment adviser's] clients' funds and securities, under [the adviser's] name as agent or trustee for the clients." 17 C.F.R. § 275.206(4)-2(a)(1)(i)-(ii). Scienter is not required to prove violations of the custody rule. SEC v. Steadman, 967 F.2d 636, 646 (D.C. Cir. 1992) ("[S]cienter is not required under [Advisers Act] section 206(4)"). The Eden Arc Adviser violated the Custody Rule by putting Fund assets—the survivor's option bonds and CDs and other assets belonging to the Fund—directly in the name of Lathen and the Participant.

As a preliminary matter, there can be no question that EACM had custody of client funds and securities because Lathen—as the managing member both of the general partner and investment adviser—had the authority to obtain possession of client funds and securities. See 17 C.F.R. § 275.206(4)-2(d)(2)(ii)-(iii). Indeed, EACM acknowledged its custody of client assets in both its Forms ADV and in internal documents, such as its Compliance Manual. Therefore, the Custody Rule applies to it. See 17 C.F.R. § 275.206(4)-2(a).

1. *Accounts Opened Before 2013*

There can also be no question that, at a minimum, the "funds or securities" in all of the Accounts opened prior to January 2013,[10] belonged to the Fund. The Investment Management Agreement, which governed all Accounts prior to that time, made clear that Lathen was holding those assets merely as a "nominee" for the Fund and he explicitly disclaimed any legal or

[10] The evidence will show that at least some of those pre-2013 Accounts still held SO notes—Fund assets—into 2015, with one containing Fund assets into early 2016.

beneficial ownership interest in those assets. Further, EACM held the assets in the joint tenant Accounts out as assets of the Fund to investors and prospective investors.[11]

Thus, at a minimum, the funds and securities in all pre-2013 Accounts, which were explicitly made subject to the Investment Management Agreement, had to be held in the name of the Fund or in the name of EACM as agent or trustee for the Fund. They were not. That failure violated the Custody Rule.

2. *Accounts Opened After 2013*

After 2013, when Respondents changed their structure and the Fund purported to loan money to Lathen, and later to Lathen and the Participants to fund newly-opened Accounts, the Eden Arc Adviser continued to violate the Custody Rule, even with respect to those newly-opened Accounts.

The Forms ADV for these later periods still acknowledged the Eden Arc Adviser's custody of the Fund's assets. And, in reality, as Respondents told their investors, the Fund's money was deposited in the Accounts and used to acquire SO investments as to which the Fund was entitled to all profits and/or losses. Consequently, these Fund assets were improperly custodied in Accounts titled to Lathen and the Participant.

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11 That Respondents considered themselves to custody the cash and securities held in the Accounts is further evidenced by their submissions to the Commission to secure their Commission registration. In order to qualify under Advisers Act Section 203A, EACM had to list "assets under management" of a certain dollar value. Since Section 203A(3)'s definition of "assets under management" includes only "the <u>securities</u> portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services" (<u>id.</u> (emphasis added)), the only way Eden Arc Adviser could have reached the necessary dollar value of assets under management to qualify for registration with the Commission would have been to either include (1) the securities held in the Accounts; or (2) what they now call loans as securities. If Eden Arc Adviser truly believed that the purported loans in its managed fund were not securities (or that the securities in the Accounts were not Fund assets), then no part of them should have been claimed as "assets under management" for the purposes of Advisers Act Section 203A(3), and the adviser should not have been registered with the SEC. <u>See</u> 15 U.S.C. § 80b-3a.

And, even if the Fund assets were only collateral for the Fund's loan to Lathen, then they were still improperly custodied in accounts titled to Lathen and the Participant. Under the Custody Rule, that loan had to be held by a qualified custodian in the name of the Fund. The Custody Rule's exemption for certain privately offered securities that are uncertificated, 17 C.F.R. § 275.206(4)-2(b)(2), does not apply because this was a certificated transaction; the loan agreement was accompanied by a promissory note that certificated the loans. As such, the Fund's assets, represented by the promissory note, should have been custodied with a qualified custodian in the name of the Fund.

Lathen admitted the violation in February 2015 in responding to the Exam Staff's summary of its findings. There, Lathen disclaimed that the Fund owned the securities in the Accounts with the Participants. But rather than argue that the Fund's note was uncertificated, or that the Eden Arc Adviser had properly custodied it, Lathen simply noted that the Eden Arc Adviser "is substantively complying" with the Custody Rule by virtue of the fact that its annual audits are a "cure for [the] risk" that the Custody Rule targeted. As a strict liability rule, the Custody Rule requires full compliance, irrespective of a violator's attempt to mitigate the risk.

C. <u>Lathen Aided and Abetted and Caused EACM's Violations of Advisers Act Section 206(4) and Rule 206(4)-2 Thereunder</u>

Aiding and abetting liability requires the Division to demonstrate:

> (1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party; (2) "knowledge" of this violation on the part of the aider and abettor; and (3) "substantial assistance" by the aider and abettor in the achievement of the primary violation.

<u>DiBella</u>, 587 F.3d at 566 (quotation marks and citations omitted). "[R]ecklessness is sufficient to satisfy the scienter requirement for aiding and abetting liability." <u>In the Matter of Gregory O. Trautman</u>, Rel. No. 9088A, 2009 WL 6761741, at *19 (S.E.C. Dec. 15, 2009).

The elements of a causing violation are substantially similar: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his conduct would contribute to the violation. In the Matter of Robert M. Fuller, Rel. No. 33-8273, 2003 WL 22016309, at *4 (Aug. 25, 2003), pet. den., 95 F. App'x 361 (D.C. Cir. 2004)). "Negligence is sufficient to establish liability for causing a primary violation that does not require scienter." In the Matter of KPMG Peat Marwick LLP, Rel. No. 34-43862, 2001 WL 47245, at *19 (S.E.C. Jan. 19, 2001), pet. den., 289 F.3d 109 (D.C. Cir. 2002)

Because Lathen is the sole person responsible for EACM's violative conduct—as detailed above—he is likewise liable for aiding and abetting and causing such conduct. Further, Lathen was the CCO of EACM (as well as the CEO, CFO and Managing Principal). As such, he was responsible for all compliance matters as laid out in the firm's Compliance Manual, including compliance with the Custody Rule. By failing to ensure compliance with the Custody Rule he acted at least recklessly in failing to assure that the Eden Arc Adviser was in compliance with it.

D. Respondents' Purported Defenses Are Unavailing

Respondents seek to avoid liability for their fraud through a variety of excuses, including (1) that New York State law controls this action; (2) that they relied on counsel in structuring their investment strategy; and (3) that they lack scienter. Each of these excuses merely proves to highlight Respondents' scienter in choosing to withhold material information from the issuers that would allow them to understand and fully evaluate the legitimacy of Respondents' redemption claims.

1. Respondents' Argument Concerning New York State Law Ignores the Securities Law Violations

Respondents contend that New York State law imbues a JTWROS account holder with immutable characteristics of ownership—ones that cannot be altered by the economic realities of

Respondents' transactions, nor their own actions and statements disclaiming Lathen's and the Participants' ownership. Therefore, according to Respondents, the statements in the Redemption Exercise Letters were accurate and not misleading. This argument entirely ignores the securities law violation that is at the heart of this proceeding, and is also wrong as a matter of law.

First, New York law cannot cure the securities law violation at issue here. Irrespective of (1) whether or not New York law applies, (2) whether it governs the interpretation of the issuers' offering documents, or (3) whether it—as Respondents argue—conclusively establishes that the Participants and Lathen were valid joint tenants, Respondents still misled counter-parties to a securities transaction by making misrepresentations and intentionally or recklessly omitting material information. Respondents understood that the issuers did not necessarily agree with their view of New York law or the ownership rights it purports to create, as evidenced by the fact that Respondents disclosed it as a risk to their investors. Nonetheless, Lathen pointedly called himself and the Participants owners, meanwhile failing to disclose to the issuers when submitting the Redemption Exercise Letters that Lathen and the Participants had disclaimed ownership rights over the bonds, and that Participants signed away all access to the Accounts prior to a single bond being purchased in or transferred to them. Thus, the fraud here has nothing to do with whether New York law deems Lathen and the Participant to be joint tenants for purposes of the Banking Law. Rather, the question is: did Respondents—by hiding information from the issuers necessary to reach their own conclusion about whether Lathen and the Participants were truly the beneficial owners of the bonds—misrepresent the bonds' ownership? The answer is yes as evidenced by issuers' reactions when they learned of the true nature of the arrangement: some disputed Respondents' view of New York law and eligibility under their respective Prospectuses, just as

Respondents feared they might. Thus, Respondents made false and misleading statements under the federal securities laws, and their arguments about New York law are simply beside the point.

Second—while they offer no explanation as to why New York law should apply to this case—Respondents are, in any event, incorrect that their opening of the Accounts, without more, created a true joint tenancy with right of survivorship under New York law. A joint tenancy is an estate held jointly by at least two persons "who have equal rights to share in its enjoyment during their lives, and where each joint tenant has a right of survivorship." Trotta v. Ollivier, 91 A.D.3d 8, 12, 933 N.Y.S.2d 66, 69 (2d Dep't 2011). Thus, in life, a key feature of a joint tenancy is that both tenants share an undivided interest in the property. See Brezinski v. Brezinski, 94 A.D.2d 969, 463 N.Y.S.2d 975, 976 (4th Dep't 1983) ("One incident of joint tenancy is that so long as both tenants are living, each has a 'present unconditional property interest in an undivided one-half of the money deposited.'"). "In a true joint account, each party has the right to withdraw one half of the funds during the lifetime of both tenants." Matter of Estate of Zecca, 152 A.D.2d 830, 831, 544 N.Y.S.2d 40, 41-2 (3d Dep't 1989).

> [I]n other words, at the time the account was opened, there must have been a present gift from the original donor to the cotenant of one half of the account which each could withdraw unilaterally while both were alive.

Id.; see also Goetz v. Slobey, 76 A.D.3d 954, 956, 908 N.Y.S.2d 237, 239 (2d Dep't 2010) ("A joint tenancy is an estate held by two or more persons jointly, with equal rights to share in its enjoyment during their lives, and creating in each joint tenant a right of survivorship.") (quotations omitted).

Here, the fact that the Participants agreed that they would not be permitted to exercise rights of ownership with respect to the SO investments or other assets in the Accounts, including that they could not "pledge, borrow against, or withdraw funds from the Account(s) without the express written permission of Lathen, which permission may be withheld in Lathen's sole discretion," and that they gave Lathen full power of attorney to acquire and dispose of all assets in the Accounts, suggests that, even before the Accounts were opened, neither Lathen nor the Participants intended that the Participants would have access to funds or securities in the Accounts.[12] Moreover, the Fund's investors would certainly have been surprised to learn—in exercising the advertised investment strategy—they were making a present gift of their funds to either Lathen or the Participants.[13] In these circumstances, the Accounts are deemed "convenience accounts," and New York courts do not apply the presumption that Respondents cite to under New York Banking Law § 675.[14] See, e.g., Estate of Zecca, 152 A.D.2d at 831, 544 N.Y.S.2d at 42; Matter of Friedman, 104 A.D.2d 366, 367, 478 N.Y.S.2d 695, 696-97 (2d Dep't 1984), aff'd sub nom. Matter of Estate of Friedman, 64 N.Y.2d 743, 475 N.E.2d 454 (1984) (holding that it was "clear from [the decedent's] actions vis a vis the subject accounts that she did not . . . intend to confer a present interest of one half on the objectant" and thus "the presumption of joint tenancy was effectively rebutted.") (quotations omitted); Fischedick v. Heitmann, 267 A.D.2d 592, 592, 699 N.Y.S.2d 508, 509 (3d Dep't 2012) (no presumption of joint

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12 As noted above, Respondents' attempt to alter the structure after 2013 did not alter the Participants' lack of access to the Accounts during their lifetimes. Thus, even under the Participant Agreements that governed Accounts opened after Respondents began using the Discretionary Line Agreements, the Participants signed Powers of Attorney signing over all rights to move funds and securities into and out of the accounts to Lathen, and they did so prior to a single bond having been purchased in or transferred into the Accounts.

13 The Fund's financial statements also made no reference to any interest in the JTWROS Accounts belonging to the Participants. Indeed, the net asset value of the Fund was reported as the full value of the assets in the JTWROS Accounts.

14 A convenience account is one set up "in the name of a depositor and another person . . . 'for the convenience' of the depositor." NY Banking Law Section § 678. The creation of a convenience account, "shall not affect the title to such deposit or shares and the depositor shall not be considered to have made a gift of one-half the deposit. . . ." Id.

tenancy where the depositor had no "intention of conferring a present beneficial interest" on the purported joint tenant).

At least one court has explicitly rejected Respondents' argument that the mere form of the Accounts trumps the economic reality of the parties' relationship. In Viggiano v. Viggiano, claimant admitted that the intention in creating the account had not been to give both parties full access to it, but rather relied "only on the fact that because of the form of the account, the defendant husband had a present interest in the account and could at any time withdraw the entire sum." 136 A.D.2d 630, 630-31, 523 N.Y.S. 2d 874, 875 (2d Dep't 1988) (emphasis added). The court easily rejected this argument, noting that the facts demonstrated no intention "to give the defendant husband any interest in the account." Id. So it is here—Respondents stripped Participants of rights to access the Accounts (indeed, hid the Accounts from them), and Lathen disclaimed his own beneficial interest in the Accounts.

2. Respondents' Advice of Counsel Defense Is Without Merit

Respondents also argue that they relied in good faith on the advice of counsel "concerning and relating to the structure of, and structuring of, the Eden Arc Respondents' investment strategy." (Letter from Harlan Protass to Hon. James E. Grimes, Sept. 23, 2016, at 1.) This argument both misses the point and is untrue.

As an initial matter, the defense has no application at all to the Custody Rule violations asserted against the Eden Arc Adviser because the Custody Rule imposes strict liability. Howard v. SEC, 376 F.3d 1136, 1147 (D.C. Cir. 2004) (advice of counsel defense is only "a relevant consideration in evaluating a defendant's scienter"); cf. In the Matter of Rodney R. Schoemann, Rel. No. 3-12943, 2009 WL 3413043, at *12 (S.E.C. Oct. 23, 2009) (holding that advice of counsel defense is irrelevant to liability under Section 5 of the Securities Act since that provision provides for strict liability), pet. den., 398 F. App'x 603 (D.C. Cir. 2010). And, with regard to the claims asserted against Lathen for aiding and abetting the Eden Arc Adviser's Custody Rule violations, no such advice of counsel defense has been asserted.

But even as to the scienter-based charges here, the defense is unavailing. The elements of the advice of counsel defense require Respondents to show that they (1) made a complete disclosure of the relevant facts to counsel; (2) sought and received advice from counsel that the conduct in question was legal; and (3) relied on that advice in good faith. See Markowski v. SEC, 34 F.3d 99, 104-05 (2d Cir. 1994). "Even where these prerequisites are satisfied, such reliance is not a complete defense, but only one factor for consideration." Id. at 105.[15]

Here the defense is irrelevant because Respondents assert that they received legal advice only as to "the structure of, and structuring of, the Eden Arc Respondents' investment strategy." (Letter from Harlan Protass to Hon. James E. Grimes, Sept. 23, 2016, at 1.) However, this case is not about whether Respondents appropriately structured their fund—from a corporate law standpoint—but whether they properly *disclosed* their side agreements and the many caveats on Lathen's and the Participants' purported ownership to the bonds' issuers. SEC v. Savoy Indus., Inc., 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981) ("Compliance with federal securities laws cannot be avoided by simply retaining outside counsel to prepare required documents"). Thus, their purported defense entirely misses the mark.[16]

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[15] Respondents' recent Brief in Opposition to the Division's Motion in Limine to Preclude Evidence Regarding Advice of Counsel mentions none of these elements, and offers no evidence to show that they can satisfy any of them. (Respondents' Brief, dated January 18, 2017.) Indeed, as they candidly concede, they received neither an "opinion about the validity of the joint tenancies at issue," nor "advice about issuer disclosure requirements." (Id. at 1.) All Respondents can offer is evidence of the *presence* of lawyers, and Respondents' apparent reliance on their *lack of advice*. This "lawyer in the room" defense has no legal effect on their scienter. SEC v. Tourre, 950 F. Supp. 2d 666, 683 (S.D.N.Y. 2013).

[16] Further to that point, Respondents' production of communications with lawyers, reflecting the advice they did seek, reflects no request for advice on the pertinent issue—

Second, the evidence shows that what relevant advice Lathen did receive on the topic of disclosure he ignored. Thus in 2012, Hinckley Allen advised him—in writing—that he should provide all relevant information to all third parties. Ms. Farrell of Hinckley Allen cautioned: "Representations to third parties, including broker-dealers, must not misrepresent Participants' contact information, Participants' finances, Participants' investment history, or the nature of the relationship between participants and you and/or EndCare. Further, such representations should not misrepresent the nature or intent of the Program." She emphasized that advice in the closing paragraphs of the same memorandum: "The risk of such claims [of misrepresentation] can best be managed by assuring that all parties involved (including Participants, broker dealers and investors) receive complete information regarding the purpose and nature of the Program and that you document their receipt of such written materials." In her interview, Ms. Farrell told the Division that she did not mean to exclude issuers from her list of third parties to whom Respondents must make full disclosure, nor did she ever advise Lathen that he should not make full disclosure to them.[17]

That Lathen understood his disclosure obligations and the materiality to the issuers of the true nature of the ownership structure he had devised, and ignored them, is evidenced by his attempts to hide the true structure of his investment strategy from the issuers exactly because he was concerned that—if they learned the truth—they would refuse to redeem. Thus, even if he had sought legal advice as to the relevant question (which he did not), he would not able to take advantage of the defense. See, e.g., Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641-43 (D.C.

disclosure to issuers—despite their recognition that disclosure to issuers might derail the redemptions they sought.

17 Indeed, that advice was consistent with what Lathen had been told by Katten Muchin back in 2009 when he first sought advice about his strategy. To the extent that Lathen may have gotten different advice from any other attorney later does not lessen his scienter. From the beginning, he was told that issuers should be given full and complete disclosure of the strategy.

Cir. 2008) (rejecting reliance-on-counsel defense when the petitioner "could not have had a genuine belief in" his statements' "completeness and accuracy"); SEC v. Goldfield Deep Mines Co. of Nevada, 758 F.2d 459, 467 (9th Cir. 1985) (rejecting reliance-on-counsel defense when defendants "knew" that statements made in public filings "were false or misleading"). As discussed in Contentions of Fact, supra, Lathen repeatedly told his investors that if issuers found out about his strategy, they might not redeem and he did keep that strategy from them.

Finally, even if Respondents were correct that advice as to the validity of the joint tenancies is relevant to their scienter on these securities fraud claims, Respondents are unable to make out the defense in that respect either.

The Division's interview of 16 lawyers on Respondents' list of attorneys they consulted on the topic of the validity of the joint tenancies reveals that none of them gave him any opinion that they were valid, and only two[18] gave him any advice at all on that subject; both told him there were uncertainties in the law that precluded them from giving him any comfort. Indeed, what the evidence will show is that Lathen made continuous efforts to obtain an opinion on the validity of his joint tenancies from eight different law firms, all of which declined to provide him with an opinion.[19]

And from 2012 forward, Lathen knew that the joint tenancies he had created with Participants under his Investment Management Agreement structure were in fact *not* valid.

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[18] One of Respondents' lawyers, Mr. Galbraith, refused to be interviewed by the Division, but it appears that any advice he gave was in the context of his representation of Lathen in various disputes with the issuers, hardly advice on which Respondents could have relied to believe that their joint tenancies were valid. Indeed, during Mr. Galbraith's representation of Lathen, Lathen was still "shopping around" for a legal opinion, reflecting that not even he relied on any advice he might have received from Galbraith.

[19] No one gave him any advice on whether the Participants had sufficient beneficial ownership interest in the Accounts, either, although Peggy Farrell repeatedly advised Lathen to strengthen the Participants' access to and right to share in the Accounts.

According to Hinckley Allen's Peggy Farrell, the joint tenancies under the Investment Management Agreement structure—by which Lathen disclaimed any ownership in the Accounts—made the Fund, not Lathen, the co-owner on the Accounts. And since—in Hinckley Allen's view—an entity could not be a joint tenant under New York law, any joint tenancies created under that structure were not valid. Farrell advised Lathen of that conclusion sometime in the summer or fall of 2012 and thereafter proceeded to advise him on creating a new structure to cure that defect, resulting in the creation of the Discretionary Line Agreement by which the Fund loaned money to Lathen (and later to Lathen and the Participants), who then formed joint tenancies with the Participants.

Notwithstanding his lawyer's conclusion that the pre-2013 joint tenancies were invalid, and with full knowledge of that legal conclusion, Lathen proceeded to redeem securities held in joint Accounts with as many as 25 Participants whose Accounts had been created under the old structure, and continued to do so through 2014. Accordingly, from late 2012 through 2014, Lathen cannot be said to have proceeded in reliance on any opinion or advice that those joint tenancies were valid. Thus, even under Respondents' own theories of their conduct and advice of counsel, the evidence will show that Lathen understood that these redemptions were improper.

As such, and as Respondents' recent briefing all but concedes, Respondents' advice of counsel defense is a red-herring. The only relevant advice he had from any lawyer was that he should make full disclosure of the true nature of the Participants' interest in the Accounts to issuers. As to the validity of the joint tenancies—whatever its relevance—the evidence will show that Lathen was unable to obtain any opinion from any law firm that they were valid. And from 2012 through 2014, Lathen actually obtained advice that any joint tenancy created under the

Investment Management Agreement structure was *invalid*, but proceeded to redeem securities held in those Accounts without disclosing that fact to issuers through at least 2014.

REMEDIES REQUESTED

The Division seeks a permanent collateral bar; cease-and-desist orders; disgorgement of ill-gotten gains along with pre-judgment interest; and civil penalties.

A. A Permanent Collateral Bar Should Be Imposed on Lathen

Advisers Act Section 203(f) and Investment Company Act Section 9(b) authorize the Commission to bar an investment adviser's associated individuals if the sanction is in the public interest and the adviser or associated person has (i) willfully violated any provision of the Securities Act or the Exchange Act, 15 U.S.C. § 80b-3(f), (e)(5) and 15 U.S.C. 80a-9(b)(2), or (ii) willfully aided and abetted another person's violation of the Advisers Act, or its rules or regulations. Id. § 80b-3(f), (e)(6) and 15 U.S.C. § 80a-9(b)(3). A "willful violation of the securities laws means intentionally committing the act which constitutes the violation' and does not require that the actor 'also be aware that he is violating one of the Rules or Acts." In the Matter of S.W. Hatfield, CPA, Rel. No. 34-73763, 2014 WL 6850921, at *9 (S.E.C. Dec. 5, 2014) (internal quotations omitted). Because Lathen has violated Securities Act Section 17(a) and Exchange Act Section 10(b), and willfully aided and abetted the Eden Arc Adviser's violations of the Custody Rule, he should be barred from the industry. Thus, the Division need only show that a permanent industry bar against Lathen is in the public interest.

In assessing the public interest, the Commission considers:

> the egregiousness of [the respondent's] actions (including his aiding and abetting of [his entity]'s fraudulent conduct, the isolated or recurrent nature of the infraction, the degree of scienter involved, his recognition of the wrongful nature of his conduct, the sincerity of his assurances against future violations, and the likelihood that his occupation will present opportunities for future violations.

In the Matter of Edgar R. Page, Rel. No. IA-4400, 2016 WL 3030845, at *5 (S.E.C. May 27, 2016) (citing Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981)) (the "Steadman factors"). "[N]o one factor is dispositive." Id.

Here, the Steadman factors establish that Lathen should receive a permanent industry bar from association because his conduct continued for more than four years. Lathen acted intentionally to hide the true facts from issuers because he understood that they would likely reject his redemption requests if they understood how he owned the bonds. When some issuers grew suspicious, Lathen fought their requests for additional information to try to keep the full ownership picture hidden. Further, he put the entire compliance function under his own supervision and thought nothing of putting assets of the Fund in his own name and the name of complete strangers, while simultaneously refusing to erect account controls. Lathen's whole professional career has been spent in some financial industry role, making it likely that he would try to return to the industry in the future.

B. Cease-and-Desist Orders Should Be Imposed on All Respondents

Pursuant to Section 8A of the Securities Act, all Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Securities Act Section 17(a). Similarly, pursuant to Section 21C of the Exchange Act, all Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Exchange Act Section 10(b). In addition, and pursuant to Section 203(k) of the Advisers Act, the Eden Arc Adviser and Lathen should be ordered to cease and desist from committing or causing violations of and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

To establish grounds for a cease-and-desist order, the Division must show that there is some likelihood of future violations, although "a single past violation ordinarily suffices to establish a risk of future violations." In the Matter of optionsXpress, Inc., Rel. No. 33-10125, 2016 WL 4413227, at *34 (S.E.C. Aug. 18, 2016) (citation omitted), order corrected on other grounds, Rel. No. 33-10206, 2016 WL 4761083 (S.E.C. Sept. 13, 2016). The Commission considers the same Steadman factors to determine whether a cease-and-desist order is appropriate. KPMG Peat Marwick LLP, 2001 WL 47245, at *23. It additionally considers "whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions." Hatfield, 2014 WL 6850921, at *10 (quotation omitted). The additional factors point to the necessity for a cease-and-desist order against Respondents. The violations occurred as recently as 2016 and only ceased after the Division had issued a Wells notice and had subsequent meetings with counsel for Respondents.

C. Disgorgement of Respondents' Ill-Gotten Gains Should Be Ordered

The Division seeks disgorgement from all Respondents pursuant to Securities Act Section 8A(e) and Exchange Act Section 21B(e). Disgorgement should be calculated as the management fees and incentive fees collected by EACA and the Eden Arc Adviser and paid for by the Fund from the Fund's inception to February 2016 in connection with the SO bonds.

"Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws." In the Matter of Montford and Co., Rel. No. IA-3829, 2014 WL 1744130, at *22 (S.E.C. May 2, 2014), pet. den., 793 F.3d 76 (D.C. Cir. 2015) (internal quotations omitted). Because separating legal from illegal profits exactly may be difficult, the amount of disgorgement imposed "need only be a reasonable approximation of profits causally connected to the violation." Id. (quoting SEC v. Patel, 61 F.3d 137, 139 (2d Cir. 1995)).

Here, the Eden Arc Adviser earned management fees ranging from 0.5% to 2% of assets under management, with different investors paying different fees. The Division has calculated that the Eden Arc Adviser earned management fees attributable to all survivor option bonds in the Fund's portfolio throughout the period as $173,669; for those survivors option bonds redeemed throughout the period, the management fees attributable to them amounts to $41,652.

Additionally, EACA, the general partner of the Fund, also wholly owned by Lathen, earned incentive fees during the period, ranging from 16% to 30% of Fund profits, with different investors paying different fees. Calculated on all survivor option bonds held in the Fund's portfolio from 2012 through 2015, the incentive fees earned totaled $1,298,898. Measured on the profits earned solely from those survivor option bonds redeemed by Respondents, the incentive fees earned throughout the period totaled $486,509. Prejudgment interest is regularly awarded to "prevent[] the violator from profiting from their securities violations." In the Matter of Richard P. Sandru, Rel. No. 34-70161, 2013 WL 4049928, at *8 (S.E.C. Aug. 12, 2013).

Year	Disgorgement Amount (All Bonds)	Prejudgment Interest	Total (Disgorgement + Prejudgment Interest)
Management Fees			
2011	$ 21,236	$ 3,772.66	$ 25,008.66
2012	48,640	6,943.79	55,583.79
2013	35,971	3,924.79	39,895.79
2014	49,982	3,821.17	53,803.17
2015	17,840	798.42	18,638.42
Total	$ 173,669	$ 19,260.83	$ 192,929.83
Incentive Fees			
2012	$ 1,074,389	$ 153,378.72	$ 1,227,767.72
2013	173,156	18,892.96	192,048.96
2014	49,768	3,804.81	53,572.81
2015	1,585	70.94	1,655.94
Total	$ 1,298,898	$ 176,147.43	$ 1,475,045.43
Total: Management Fees and Incentive Fees for All Bonds			
	$ 1,472,567	**$ 195,408.26**	**$ 1,667,975.26**

Year	Disgorgement Amount (Redeemed Bonds)	Prejudgment Interest	Total (Disgorgement + Prejudgment Interest)
Management Fees			
2011	$ 12,653	$ 2,245.02	$ 14,898.02
2012	15,834	2,260.45	18,094.45
2013	9,282	1,012.76	10,294.76
2014	3,740	285.92	4,025.92
2015	143	6.40	149.40
Total	$ 41,652	$ 5,810.55	$ 47,462.55
Incentive Fees			
2012	$ 439,660	$ 62,765.41	$ 502,425.41
2013	35,139	3,834.01	38,973.01
2014	11,606	887.29	12,493.29
2015	104	4.65	108.65
Total	$ 486,509	$ 67,491.36	$ 554,000.36
Total: Management Fees and Incentive Fees for Redeemed Bonds			
	$ 528,161	**$ 73,301.91**	**$ 601,462.91**

D. Second Tier Penalties Are Appropriate for the Securities Act and Exchange Act Violations and Third Tier Penalties for the Custody Rule Violations

Second tier penalties for the fraud violations should be imposed here. Pursuant to Securities Act Section 8A(g), Exchange Act 21B(a) and Advisers Act Section 203(i), the same three-tier penalty structure applies, varying by the year of the conduct. For conduct from 2011-2013, for violations that involve "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," civil penalties of $75,000 for a natural person or $375,000 for an entity are authorized; for conduct from 2014-2105 civil penalties of $80,000 for a natural person and $400,000 for an entity are authorized. 15 U.S.C. § 77h-1(g); 15 U.S.C. § 78u-2(a); and 15 U.S.C. § 80b-3(i).[20]

The Division will prove violations that involved fraud, deceit, manipulation or deliberate or reckless disregard of a regulatory requirement and thus penalties should be awarded at the second tier. Six factors are considered when determining whether an award of penalties will serve the public interest: (1) Whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, (2) the resulting harm to other persons, (3) any unjust enrichment and prior restitution, (4) the respondent's prior regulatory record, (5) the need to deter the respondent and other persons, and (6) such other matters as justice may require. E.g., 15 U.S.C. § 78u-2(c); 15 U.S.C. § 80b-3(i)(3).

Here, second tier penalties are appropriate and in the public interest for Respondents' violations of the Securities Act and the Exchange Act. Respondents' flagrant deception of issuers constitutes fraud and deceit. And while there is no specific evidence of harm to the

[20] These figures represent the inflation-adjusted statutory amounts imposed by the Debt Collection Improvement Act of 1996. 17 C.F.R. §§ 201.1004 and 201.1005.

issuers, or prior regulatory infractions, there is an obvious need to deter these Respondents as well as other advisers from similar conduct.

For the Eden Arc Adviser's violations of the Custody Rule, and Lathen's aiding and abetting those violations, third tier penalties are appropriate because the violations "involved fraud, deceit, manipulation or deliberate or reckless disregard of a regulatory requirement," and the violation, "directly or indirectly . . . created a significant risk of substantial losses to other persons." 15 U.S.C. § 80b-3(i)(2)(c).

The Custody Rule was adopted by the Commission pursuant to its authority granted by Section 206(4) to prescribe "rules and regulations defin[ing], and prescrib[ing] means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive or manipulative." Thus, a Custody Rule violation is an "act, practice, or course of business which is fraudulent, deceptive or manipulative," and merits third tier penalties. But even were it something less than fraud, a violation of the Custody Rule, year after year—after Lathen was told by his lawyers that maintaining accounts under the Investment Management Agreement structure would make the Fund the true owner of the assets, and while Lathen bore the sole responsibility for ensuring the Adviser's compliance with the Custody Rule—meant that he and the Eden Arc Adviser were, at the very least, recklessly disregarding the regulatory requirement of the rule.

And the violations "created a significant risk of substantial losses" to Fund investors – indeed the very risk that the Custody Rule was meant to mitigate. From late 2012 (once Eden Arc Adviser had registered with the Commission) through 2016, the Eden Arc Adviser and Lathen held Fund securities in Accounts titled in his and a Participant's name, giving Lathen the unfettered ability to abscond with the securities. That the risk of that conduct did not materialize in real harm to Fund investors is of no moment. Third tier penalties are appropriate when merely the risk of significant harm, as here, is present. For 2013, authorized third tier penalties for individuals are $150,000 and $725,000 for entities; for 2014-2015, those amounts are $160,000 and $775,000, respectively.[21]

The Division calculates the violations and resulting penalties as follows:

Respondent	Violations		Number of Violations	Penalty Tier and Amount	Penalty
	Statute	Years Violated			
Eden Arc Adviser	• Securities Act Section 17(a)	2011-2013[22]	3	Second Tier ($375,000)	$1,125,000
		2014-2015[23]	2	Second Tier ($400,000)	$ 800,000
	• Exchange Act Section 10(b)	2011-2013	3	Second Tier ($375,000)	$1,125,000
		2014-2015	2	Second Tier ($400,000)	$ 800,000
	• Advisers Act Rule 206(4)-2	2013	1	Third Tier ($725,000)	$ 725,000
		2014-2015	2	Third Tier ($775,000)	$1,550,000
Total			13		$6,125,000

21 And to the extent that other Accounts were governed by the Discretionary Line Agreement, Eden Arc Adviser violated the Custody Rule with respect to those Accounts as well because in reality, as Respondents told their investors, it was the Fund's money: the Fund's money was deposited in the Accounts and used to acquire SO investments as to which the Fund was entitled to all profits and/or losses. Consequently, these Fund assets were improperly custodied in Accounts titled to Lathen and the Participant. And, even if the Fund assets were only collateral for the Fund's loan to Lathen, then they were nevertheless improperly custodied in Accounts titled to Lathen and the Participant. Under the Custody rule, that loan, as a certificated security, had to be held by a qualified custodian in the name of the Fund.

22 The Division has used the lower adjustments applicable to violations occurring before March 5, 2013 for the entire 2013 period. 17 C.F.R. § 201.1004.

23 The Division has used the lower adjustments applicable to violations occurring before November 2, 2015 for the entire 2014-2015 period. 17 C.F.R. § 201.1005.

Respondent	Violations		Number of Violations	Penalty Tier and Amount	Penalty
EACA	• Securities Act Section 17(a)	2011-2013	3	Second Tier ($375,000)	$1,125,000
		2014-2015	2	Second Tier ($400,000)	$ 800,000
	• Exchange Act Section 10(b)	2011-2013	3	Second Tier ($375,000)	$1,125,000
		2014-2015	2	Second Tier ($400,000)	$ 800,000
Total			10		$3,850,000

Lathen	• Securities Act Section 17(a)	2011-2013	3	Second Tier ($75,000)	$ 225,000
		2014-2015	2	Second Tier ($80,000)	$ 160,000
	• Exchange Act Section 10(b)	2011-2013	3	Second Tier ($75,000)	$ 225,000
		2014-2015	2	Second Tier ($80,000)	$ 160,000
	• Advisers Act Rule 206(4)-2 (aiding and abetting)	2013	1	Third Tier ($150,000)	$ 150,000
		2014-2015	2	Third Tier (160,000)	$320,000
Total			13		$1,240,000

CONCLUSION

The Division of Enforcement intends to demonstrate that Respondents committed the above-described violations of the Securities Act, the Exchange Act, and the Advisers Act and that the requested sanctions are appropriate.

Dated: January 20, 2017
New York, New York

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17387

In the Matter of

DONALD F. ("JAY") LATHEN, JR.,
EDEN ARC CAPITAL
MANAGEMENT, LLC,
and EDEN ARC CAPITAL ADVISORS,
LLC,

Respondents.

Certificate of Service

I hereby certify that I served (1) the Division of Enforcement's Prehearing Brief, dated January 20, 2017; and (2) the Declaration of Nancy A. Brown, executed January 20, 2017, and all exhibits attached thereto on this 20th day of January 2017, on the below parties by the means indicated:

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