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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17686

In the Matter of

JAMES Y. LEE,

Respondent.

DIVISION OF ENFORCEMENT'S MOTION FOR DEFAULT AND IMPOSITION OF SANCTIONS AGAINST RESPONDENT JAMES Y. LEE

The Division of Enforcement ("Division") hereby moves, pursuant to the Order Following Prehearing Conference (AP Rulings Release No. 4488), dated December 28, 2016, and Rules 155(a), 220(f), and 221(f) of the Commission's Rules of Practice,[1] for entry of an order determining this proceeding against Respondent James Y. Lee ("Lee") and imposing sanctions. Specifically, the Division requests that Lee be barred from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization ("NRSRO").

[1] 17 C.F.R. §§ 201.551(a), 201.220(f), and 201.221(f).

I. Background

A. Allegations in the OIP.

On November 17, 2016, the Order Instituting Proceedings ("OIP") in this matter was issued. Advisers Act Rel. No. 4571. This proceeding was instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"). 15 U.S.C. § 80b-3(f).

In the OIP, the Division alleges that, on July 15, 2016, in the civil action captioned *Securities and Exchange Commission v. James Y. Lee, et al.*, Case No. 14-CV-0347-LAB-BGS, in the United States District Court for the Southern District of California (the "Civil Action"), a final judgment was entered permanently enjoining Lee from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act. OIP ¶ II.2. The OIP further alleges that beginning in approximately December 2008, Lee acted as an unregistered investment adviser. OIP ¶ II.1. The OIP also summarizes the allegations forming the basis of the Civil Action. OIP ¶ II.3.

B. The Underlying Civil Action.

On February 13, 2014, the Commission filed the Civil Action against Lee and certain relief defendants. The complaint in the Civil Action described in detail the manner in which Lee carried out a scheme to defraud investment advisory clients by, among other means, various misrepresentations and omissions about his credentials and the risks associated with the securities trading he would (and later did) undertake with client money.[2]

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[2] In support of this Motion, the Division submits as exhibits certain filings in the Civil Action, which are attached to the Declaration of Jennifer Peltz ("Peltz Decl."), specifically including: the Commission's complaint (Ex. A); Lee's signed consent to the entry of permanent injunction (Ex. B); and the final judgment that includes the district court's order of permanent injunction

1. The Allegations of the Injunctive Complaint.

Between late 2008 and early 2012, Lee solicited and managed investor money under the guise of being an experienced trader and corporate adviser of immense wealth. During this same time period, Lee owed the federal government over five million dollars for past illegal conduct:

- In 1997, Lee was convicted of wire fraud and pension embezzlement in connection with his role as the chief financial officer of a mortgage company that ceased operation in 1993. *See* Peltz Decl., Ex. A, Compl. ¶ 41. He was sentenced to 30 months in prison and ordered to pay $2,880,000 in restitution, which remains unpaid. *Id.*
- In 2008, Lee was sanctioned in a Commission administrative law proceeding for his role in unlawful penny stock offerings. *Id.* ¶ 41. He was ordered to pay disgorgement of $2,886,375 plus prejudgment interest. *Id.* ¶ 43; *see also* Securities Act Release No. 8954. Lee has not made any payments to satisfy this obligation.[3]

It was not long after he was sanctioned in the Commission administrative proceeding in 2008 that Lee began to solicit investors to hire him to conduct on-line trading of stock options in exchange for a share of the profits. Between March 2009 and May 2011, at least 24 clients opened and funded brokerage accounts for purposes of investing in options through Lee. Peltz Decl., Ex. A, Compl. ¶¶ 30-31. These clients provided Lee with their user and password information, and

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(Ex. C). Attached as additional exhibits to the Declaration are certain filings in a related criminal case, *United States v. Lee*, 14-cr-02937-BEN (S.D. Cal.). Pursuant to Commission Rule of Practice 323, 17 C.F.R. § 201.323, the ALJ may take judicial notice of these filings.

[3] To avoid paying these substantial debts, Lee avoided receiving income or holding assets in his own name. Compl. ¶¶ 6, 72. He used friends, family and associates as financial intermediaries. *Id.* ¶¶ 18-24. He caused various shell companies to be formed that were ostensibly owned and controlled by such other individuals, but in reality Lee was the one who pulled the strings. *Id.* ¶¶ 72, 86.

Lee exercised nearly complete control over the client brokerage accounts. *Id.* ¶ 32. He determined what options should be traded and when. *Id.* He executed the trades in the accounts, or directed others to do so per his instructions. *Id.*

Most clients were somehow connected to one of two early Lee investors, who referred their relatives and/or friends to Lee. *Id.* ¶ 33. During introductory meetings with these clients, which were often held in hotel conference rooms or suites, Lee portrayed himself as a highly successful financier who now enjoyed helping others to make money. *Id.* ¶¶ 33-34. Among other things, Lee told investors that:

- he had a law degree, an MBA, PhD and was a CPA (*id.* ¶ 35);
- he had over 20 years of trading experience, including on the floor of the New York Stock Exchange and at large broker-dealers (*id.* ¶ 36);
- he advised companies on tax, acquisition and/or financing matters (*id.*); and
- he had a large research team in China that helped him to identify profitable options trades (*id.* ¶ 37).

But when touting his purported professional record, Lee failed to disclose his past legal troubles. *Id.* ¶¶ 2, 40-43. Lee's clients were not told about his prior criminal conviction or securities law violations. *Id.* ¶¶ 40-41. These omissions were intentional. When Lee spoke of his mortgage industry background, he did so only in glowing terms, telling at least one investor that he built and then sold a mortgage company for a lot of money. *Id.* ¶ 42. When an investor happened to learn about the SEC sanctions against Lee and confronted him with this information, Lee placated the investor by falsely claiming that he had eventually been removed from the Commission proceeding. *Id.* ¶44.

Lee misled his clients about something else critical to their investment decisions—the safety of the options trading accounts he managed. *Id.* ¶ 46. Many of Lee's clients had limited investment experience and no prior options trading experience. *Id.* ¶ 29. Lee, however, did not discuss with clients the risks of options trading, in particular the risks of his preferred strategy of writing uncovered option positions. *Id.* ¶ 48. Lee also did not disclose to clients the related risks involved with his trading on "margin." Instead of making these risk disclosures, Lee made empty guarantees. Among other things, Lee told investors that:

- he would closely monitor account performance to adhere to conservative trading guidelines he established, which ensured consistently positive results (*id.* ¶ 47);
- he would split any realized losses with them "50/50," repaying them out of his own supposedly "deep pockets" (*id.* ¶¶ 51-53); and
- his trading platform included the application of "stop-losses," or risk controls, that prevented clients from losing more than 10% (*id.* ¶ 54).

Despite Lee's claims about the safety of client investments, all of Lee's clients faced margin calls and suffered substantial losses in their accounts. *Id.* ¶ 55. By early 2012, Lee's clients collectively had lost over $11 million. *Id.* ¶ 56. Lee failed to share in client losses as promised and as demanded by clients. *Id.* ¶ 57. He repaid less than $200,000 and most clients received nothing. *Id.*

Lee also defrauded certain clients by knowingly charging fees based on overstated investment results. Lee told prospective clients that they would pay 50% of monthly realized profits as management fees. *Id.* ¶ 60. This equal sharing of profits was the bargain clients made for the equal sharing of losses promised by Lee. *Id.* ¶ 51. Lee charged fees to three of his investment advisory clients based on false account performance for February 2011—concealing

from the clients that they had actually incurred net realized losses that month (such that no fees were due). *Id.* ¶ 62. Lee's initial plan was to spread these losses over five months, so he charged only one-fifth of the realized losses against the realized gains for February 2011, creating the appearance the clients had fee-generating profits. *Id.* ¶ 63. Thereafter, Lee simply ignored the remainder of the February losses altogether. *Id.* ¶ 64.

As alleged in the OIP, the District Court entered a final judgment by consent against Lee on July 15, 2016. The final judgment permanently enjoined Lee from violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act. *See* Peltz Decl., Exs. B and C. The final judgment also required Lee to pay disgorgement of ill-gotten gains in the amount of $1,880,263, and prejudgment interest in the amount of $322,762.95. *Id.*[4] To date, he has not paid these amounts.

C. The Related Criminal Action.

On or about October 9, 2014, approximately eight months after the Civil Action was filed, Lee pled guilty to obstructing justice by engaging in fraudulent and deceptive conduct designed to frustrate the federal government's collection on his 1997 criminal judgment and restitution order. *See* Peltz Decl. Ex. D. In his plea agreement, Lee admitted much of the fraudulent conduct alleged in the Civil Action. Among other things, Lee admitted that he:

- "solicited clients to conduct on-line trading on their behalf in exchange for a share of profits" (*id.* at Section II, ¶ 3(a));
- "induced potential clients to hire [him] by fraudulently making false representations and promises, and omitting material information" (*id.* at Section II, ¶ 3(b));

[4] Because, as discussed herein, Lee was the subject of a related criminal proceeding in which he received a prison sentence, the Commission withdrew its claims for civil monetary penalties in the Civil Action.

- "instructed clients to send his management fees to bank accounts he opened in the name of shell corporations" (*id.* at Section II, ¶ 3(c)); and
- "sent falsified invoices to clients to ensure that he would continue to fraudulently receive income without the knowledge of the United States" (*id.* at Section II, ¶ 3(e)).

The plea agreement includes examples of specific misrepresentations and omissions by Lee, such as misrepresenting to a client, in approximately September 2009, that Lee "was a CPA" and "had Ph.D., J.D., and M.B.A. degrees" while failing to disclose his 1997 criminal conviction. *Id.* at Section II, ¶ 4(c). With respect to this same client, Lee admitted that "he restructured billing invoices to spread losses over five months in order to avoid having to immediately pay 50% of realized losses" incurred in January 2011. *Id.* at Section II, ¶ 4(d). Finally, in the plea agreement, Lee admitted that his fraudulent conduct caused specified victims to lose over $10 million. *Id.* at Section II, ¶ 4(g).

On October 16, 2014, at Lee's change of plea hearing, he testified that he understood the terms of the plea agreement and confirmed that the facts set forth in the plea agreement were true. *See* Peltz Decl., Ex. E, pp. 13-20. On May 21, 2015, a judgment was entered in the criminal action sentencing Lee to 78-months imprisonment. *See* Peltz Decl., Ex. F.

D. Procedural Status of this Proceeding.

On the date the OIP was issued, November 17, 2016, the Commission's Office of the Secretary sent by Certified Mail, Return Receipt Requested, correspondence to Lee that enclosed the OIP. The Office of the Secretary mailed the correspondence to Lee at the below address, which is a federal correctional institution where he is incarcerated serving the sentence resulting from his conviction in the criminal case:

James Y. Lee
Register No. [redacted]
[redacted]
P.O. Box [redacted]
Taft, CA [redacted]

Among other things, the letter from the Office of the Secretary specifically referenced Section IV of the OIP, which sets out the requirement for Lee to file an answer to the OIP within twenty (20) days. The Office of the Secretary received the return receipt, indicating that the certified mailing containing the OIP and letter from the Office of the Secretary had been received and signed for at Taft Correctional Institution on November 21, 2016. A copy of the letter from the Office of Secretary that enclosed the OIP was also mailed to attorney John Kirby, who previously had represented Lee in the Civil Action the related criminal action. On December 7, 2016, Mr. Kirby informed the Division in writing that he would not be representing Lee in this proceeding. *See* Declaration of Michael Foster (dated Jan. 6, 2017, previously submitted) at ¶¶ 3-4.

On December 12, 2017, the Court issued an order setting a telephonic prehearing conference for December 21, 2017. On December 9 and 19, 2016, counsel for the Division spoke with Dale Patrick, Litigation Coordinator at the Taft Correctional Institution, to arrange for Lee's participation in the telephonic prehearing conference. *Id.* at ¶ 5. On December 19, 2016, the Division faxed Mr. Patrick a letter that provided the dial-in information for the telephonic prehearing conference and enclosed a copy of the order (Release No. 4435) scheduling the conference. *Id.* On December 20, 2016, the Division received an email from Mr. Patrick indicating that Lee was aware of this proceeding but had declined to participate in the prehearing conference. *Id.* ¶ 6. Consistent with the information in this email, Lee did not join the prehearing conference nor did any counsel appear on his behalf.

Following the prehearing conference, the Court ordered Lee to answer the OIP by January 9, 2017. AP Rulings Release No. 4488 (Dec. 28, 2016). When no answer was filed by or on behalf of Lee by this deadline, the Court ordered Lee to show cause, by January 23, 2017, why the proceeding should not be determined against him due to his failure to file an answer, appear at the prehearing conference, or otherwise defend the proceeding. AP Rulings Release No. 4516 (Jan. 11, 2017). Lee has not responded to the order to show cause.

II. Argument

Section 203(f) of the Advisers Act authorizes the Commission to impose a variety of sanctions against a person who is, among other things, enjoined from "engaging in or continuing any conduct or practice ... in connection with the purchase or sale of any security," and who was, at the time of the misconduct underlying the injunction, associated with or seeking association with, an investment adviser. 15 U.S.C. § 80b-3(e),(f). The requirements for applying Advisers Act Section 203(f) have been met here. Lee acted as an investment adviser from at least late 2008 through early 2012. During that time period, he willfully violated provisions of the Securities Act, the Exchange Act, and the Advisers Act. As a result, Lee was permanently enjoined from conduct in connection with the purchase or sale of a security – namely, violating the antifraud provisions of those federal securities laws.

Accordingly, the Division seeks to bar Lee from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or NRSRO. As set forth below, this industry-wide bar will serve the public interest and the protection of investors, and may be lawfully imposed against Lee, even though a portion of his misconduct occurred prior to

the July 21, 2010 enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").[5]

A. The Allegations of the OIP and the Complaint in the Underlying Civil Action Should Be Accepted as True.

Lee is in default for failing to file an answer, appear at the prehearing conference, or otherwise defend this proceeding. *See* 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f). Thus, the OIP's allegations should be deemed to be true. *See* 17 C.F.R. § 201.155(a); *see also* 17 C.F.R. § 201.220(c) (failure to deny OIP's allegations constitutes an admission of the same). The Court may also take judicial notice of the record in the Civil Action and the related criminal case. *See* 17 C.F.R. § 201.323

As established by the incontrovertible allegations of the Commission's injunctive complaint,[6] which are confirmed by Lee's admissions in his criminal plea agreement, Lee lied to potential investors to induce investment. He lied about his credentials and misrepresented the risks inherent in the stock option gambles he sought to (and did) make with other people's money. Lee also lied to existing client investors so that they would think their investments where performing well and he was entitled to compensation. In addition to losing large sums from Lee's options trading, investors paid over $2.5 million in fees to shell companies that Lee used to give his operation a veneer of legitimacy and shield his income from financial obligations he owed to the federal government for past criminal and civil offenses. During the time period of this misconduct, Lee was acting as an investment adviser as defined by Advisers Act Section 202(a)(11). 15 U.S.C.

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[5] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[6] *See, e.g., Marshall E. Melton*, Advisers Act Release No. 2151, 2003 WL 21729839, at *9 (July 25, 2003) ("if the Commission institutes an administrative proceeding ... based on an injunction to which [a respondent] consented" the respondent "may not dispute the factual allegations of the injunctive complaint in the administrative proceeding").

§ 80b-2(a)(11) ("any person who, for compensation, engages in the business of advising others, ... as to the value of securities or as to the advisability of investing in, purchasing, or selling securities"); *see Abrahamson v. Fleschner,* 568 F.2d 862, 870 (2d Cir. 1977) (persons who manage the funds of others for compensation are "investment advisers" within the meaning of the Advisers Act).

As a result of his misconduct, Lee was permanently enjoined from violating the antifraud provisions of the federal securities laws, and pled guilty to obstruction of justice. Lee's misconduct warrants the imposition of severe sanctions in the form of a full collateral bar.

B. A Full Collateral Bar Against Lee is in the Public Interest.

A full collateral bar against Lee is appropriate and in the public interest for the protection of investors pursuant to the factors set forth in *Steadman v. SEC*, 603 F.2d 1126 (5th Cir. 1979). The following are relevant considerations in making this public interest determination: the egregiousness of the respondent's actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent's assurances against future violations, if any; the respondent's recognition of the wrongful nature of his conduct; and the likelihood that the respondent's occupation will present opportunities for future violations. *Id.* at 1140. The inquiry into the appropriate sanction to protect the public interest is flexible, and no one factor is dispositive. *Gary M. Kornman,* Exchange Act Release No. 59403, 95 S.E.C. Docket 590, 2009 WL 367635 at *6 (Feb. 13, 2009). The Commission also considers the deterrent effect of administrative sanctions. *See Schield Mgmt. Co.*, Exchange Act Release No. 53201, 87 S.E.C. Docket 695, 2006 WL 231642, at *8 (Jan. 31, 2006).

Lee's misconduct was egregious, recurrent and intentional. The factual allegations in the Commission's injunctive complaint, which the Court may rely on, describe how Lee defrauded

multiple investors across multiple states over multiple years by misrepresenting his background and the risks and performance of his options trading program. Lee's admissions in the related criminal case confirm that he acted with a high level of scienter. *See Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980) (scienter refers to "a mental state embracing intent to deceive, manipulate, or defraud"). Lee financially benefited from his fraudulent conduct, while his clients lost millions. In the Civil Action, it was determined that Lee was unjustly enriched by approximately $1.9 million, and in the related criminal case it was determined that investors were entitled to more than $10 million in restitution from Lee.

The egregiousness of Lee's conduct is apparent when compared to his fiduciary duty as an investment adviser. Section 206 of the Advisers Act "establishes a statutory fiduciary duty for investment advisers to act for the benefit of their clients, requiring advisers to exercise the utmost good faith in dealing with clients, to disclose all material facts, and to employ reasonable care to avoid misleading clients." *Transamerica Mortg. Advisors, Inc. v. Lewis,* 444 U.S. 11, 17 (1979); *see also Burks v. Lasker*, 441 U.S. 471, 482 n.10 (1979); *Santa Fe Indus., Inc. v. Green,* 430 U.S. 462, 472 n.11 (1977). Section 206 applies to "any investment adviser" whether registered with the Commission or not. *See* 15 U.S.C. § 80b2(11) (defining investment adviser). Lee's conduct falls so far below what the law expects of investment advisers that his lack of integrity and unfitness to remain in the securities industry (in any capacity) is well established.

Any recognition of wrongdoing represented by Lee's guilty plea in the related criminal case is diminished by the fact that the obstruction of justice charge itself arose from Lee's long-standing efforts to shield his assets and income (including the illicit profits of his most recent securities law violations) from the federal government to avoid paying substantial debts owed from past misdeeds.

Lee's guilty plea is, in effect, an acknowledgement that he had refused to accept responsibility for his violations of federal law.

Moreover, Lee has not provided any assurances against future violations and there is a substantial risk that he will engage in illegal conduct in the securities industry in the future. He has a demonstrated pattern of attempting to work (or pose) as a securities professional when he is in financial need. He has a history of violating federal law and then trying to sidestep financial accountability. The Division submits that, especially in light of his past dishonest conduct, Lee should be barred permanently from association with any investment adviser. *See, e.g., Peter Siris*, Exchange Act Release No. 71068, 107 S.E.C. Docket 4642, 2013 WL 6528874, at *6 (Dec. 12, 2013) (Commission has "repeatedly held that conduct that violates the antifraud provisions of the securities laws is especially serious and subject to the severest of sanctions under the securities laws" (internal quotation marks omitted)); *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635 at *7 ("The securities industry presents a great many opportunities for abuse and overreaching, and depends very heavily on the integrity of its participants. Indeed, the importance of honesty for a securities professional is so paramount that we have barred individuals even when the conviction was based on dishonest conduct unrelated to securities transactions or securities business." (internal quotation marks and footnote omitted)).

Because the Commission considers conduct involving fraud and dishonesty to be particularly serious and subject to severe sanctions, the full collateral bar sanctions authorized by the Dodd-Frank Act should also be entered here. Section 925 of the Dodd-Frank Act amended Section 203 of the Advisers Act to permit the Commission to bar a person not only from association with investment advisers, but also from association with brokers, dealers, municipal securities dealers, municipal advisors, transfer agents, and NRSROs. This collateral bar authority

became effective on July 22, 2010. Although Lee's misconduct began prior to Dodd-Frank's enactment (continuing thereafter), the collateral bar provisions of the Act can be lawfully applied to him without concern of retroactivity. *See, e.g., Eric W. Johnson*, Initial Decision Release No. 845, 2015 WL 4572959, at *3 (July 30, 2015) ("[T]he imposition of a full collateral bar is not impermissibly retroactive because a portion of the misconduct for which [respondent] was enjoined post-dated the July 22, 2010, effective date of the Dodd-Frank Wall Street Reform and Consumer Protection Act."); *Candice D. Campbell*, Initial Decision Release No. 3491, 2012 WL 5210801, at *3 (Oct. 23, 2012) ("Because [respondent]'s misconduct continued after July 22, 2010, the effective date of Dodd-Frank, a complete collateral bar does not implicate any retroactivity issues and, thus, will be imposed."); *see also Bartko v. SEC*, -- F.3d --, 2017 WL 167479, at **4-7 (D.C. Cir. Jan. 17, 2017) (holding that collateral bars imposed by Commission, based exclusively on pre-Dodd-Frank conduct, were impermissibly retroactive).

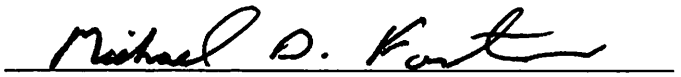
III. Conclusion

For the foregoing reasons, the Division respectfully requests that the ALJ enter an order determining the proceeding against Lee and barring him from association with any investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or NRSRO.

Respectfully submitted,

DIVISION OF ENFORCEMENT

By its attorneys,



Michael D. Foster, Senior Trial Counsel
Jennifer Peltz, Senior Counsel
Chicago Regional Office
175 West Jackson Boulevard, 9th Floor
Chicago, IL 60604

Phone: (312) 886-8520
Fax: (312) 353
Email: fostermi@sec.gov

Dated: January 30, 2017

Certificate of Service

I certify that on January 30, 2017, in addition to filing the same with the Secretary of the Commission, I caused true and correct copies of the foregoing **Division of Enforcement's Motion For Default and Imposition of Sanctions Against Respondent James Y. Lee** to be served on the following:

(By overnight delivery and email)
Honorable Brenda P. Murray
Office of Administrative Law Judges
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

(By Certified Mail)
James Y. Lee
Register No. [redacted]
[redacted]
P.O. Box [redacted]
Taft, CA [redacted]

Michael D. Foster

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
CHICAGO REGIONAL OFFICE
175 West Jackson Boulevard, Suite 900
CHICAGO, IL 60604
TELEPHONE: (312) 353-7390
FAX: (312) 353-7398

MICHAEL D. FOSTER
DIRECT DIAL: (312) 886-8520
Email: fostermi@sec.gov

January 30, 2017

RECEIVED
JAN 31 2017
OFFICE OF THE SECRETARY

VIA UPS

Brent J. Fields
Office of the Secretary
U.S. Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549

Re: ***In the Matter of James Y. Lee*, Administrative Proceeding File No. 3-17686**

Dear Mr. Fields:

Enclosed for filing in the above referenced administrative proceeding, please find a non-facsimile original of the Division of Enforcement's Motion for Default and Imposition of Sanctions Against Respondent James Y. Lee, which was filed today via facsimile transmission to: 703-813-9793.

Sincerely,

Michael D. Foster
Senior Trial Attorney

Enclosures