UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-17849

In the Matter of

ANGEL OAK CAPITAL PARTNERS, LLC, PERAZA CAPITAL & INVESTMENT, LLC, SREENIWAS PRABHU, AND DAVID W. WELLS,

Respondents.

DIVISION OF ENFORCEMENT'S POST-HEARING REPLY MEMORANDUM OF LAW

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The Division of Enforcement ("the Division") of the Securities and Exchange Commission ("the Commission" or "SEC"), respectfully submits this Post-Hearing Reply Memorandum of Law following the Hearing in this matter on May 29 and May 30, 2019 in Miami, Florida (the "Hearing").

OVERVIEW

Peraza Capital & Investment LLC ("Peraza") has filed a Post-Hearing Memorandum ("Peraza Memorandum") that fails to refute the Division's evidence on either the appropriate disgorgement amount or the requested first-tier penalty sought by the Division. Since the Commission issued the Order Instituting Proceedings (the "OIP") in this matter, Peraza has been teasing the prospect that it could justify reducing its disgorgement amount by proving the viability of some expense claims. But the Hearing showed that Peraza's evidence did not justify the deduction of its purported expenses. All Peraza offered was the unsubstantiated, after the fact, "allocations" created by its own bookkeeper, Xiomara Perez ("Perez"). These "allocations" were admittedly created solely for the purpose of defending Peraza's position during the Division's investigation. (Hearing Transcript at 104-05.) Perez admitted that she had contemporaneously identified *other* expenses that she directly attributed to the Angel Oak Capital Partners, LLC ("Angel Oak Partners") trading, and withheld those expense amounts from the commissions shared with the Atlanta operation. (Hearing Transcript at 80-81.) No explanation was offered at the Hearing as to why these after-the-fact "allocations" had not also been deducted from the 85% share of commissions designated for Atlanta. Moreover, Peraza offered no description of any recognized methodology for attributing these expenses to the Atlanta trading. Indeed, no evidence was offered at the Hearing that *any* consistent methodology was used to allocate such "expenses." In sum, all Peraza offered at the Hearing, and all it has presented in the Peraza Memorandum, was an "allocation" assertion that lacked any detail, methodological basis, or analytic

process. There is absolutely no basis for allowing the "allocations" that Peraza claims. Unquestionably, Peraza failed to meet its burden of proof on the allocation of these expenses.

As to the Division's request for a first-tier penalty, Peraza basically argues that it does not meet ***all*** of the factors identified in the relevant statutory and case law, and therefore it should be given a pass. But there is no requirement that the Division show that a respondent meets all of the factors. How many factors the Division proves may affect the size of the penalty, but the Division is already limiting its request to the $75,000 statutory amount, rather than a penalty equal to the amount of unjust enrichment. That is fair and reasonable under the circumstances.

I. THE DIVISION'S DISGORGEMENT EVIDENCE MEETS ITS BURDEN.

The relevant law on the Division's burden of proof for disgorgement is settled:

> The SEC is entitled to disgorgement upon producing a reasonable approximation of a defendant's ill-gotten gains. *See SEC v. First City Fin. Corp.,* 890 F.2d 1215, 1231–32 (D.C. Cir.1989); *see also SEC v. Warde,* 151 F.3d 42, 50 (2d Cir. 1998) (accord); *SEC v. First Pac. Bancorp.,* 142 F.3d 1186, 1192 n. 6 (9th Cir.1998) (accord). The burden then shifts to the defendant to demonstrate that the SEC's estimate is not a reasonable approximation. *See First City Fin. Corp.,* 890 F.2d at 1232. Exactitude is not a requirement; "[s]o long as the measure of disgorgement is reasonable, any risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty." *Warde,* 151 F.3d at 50 (internal citation omitted); *First City Fin. Corp.,* 890 F.2d at 1231–32.

SEC v. Calvo, 378 F.3d 1211, 1217 (11th Cir. 2004). *Accord SEC v. Monterosso*, 756 F.3d 1326, 1337 (11th Cir. 2014); *SEC v. Merch. Capital, LLC*, 486 Fed. App'x 93, 96 (11th Cir. 2012); *SEC v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1096 (9th Cir. 2010); *SEC v. First City Fin. Corp.,* 890 F.2d 1215, 1232 (D.C.Cir. 1989).

There can be no question that the Division satisfies this burden here. The disgorgement number proposed by the Division -- $1,180,487.98 -- is not just a reasonable approximation, it is an exact number that comes straight from Peraza's books and records. Nothing that came into

evidence at the Hearing changes the basic measure of what is due. Indeed, the Peraza Memorandum agrees that the Hearing showed that Peraza received $1,180,487.98 from the Atlanta trading during the relevant period. (Peraza Memorandum, at 3, item 9.) Under well-settled law, the Division has met its burden to provide a "reasonable approximation" of the Respondent's ill-gotten gains.

II. PERAZA FAILED TO MEET ITS BURDEN OF PROOF TO CHALLENGE THE DIVISION'S REASONABLE APPROXIMATION OF DISGORGEMENT.

Based on these facts, the burden of proof for reducing the Division's disgorgement number – by any argument or evidentiary presentation – shifts to Peraza. At the Hearing, Peraza failed to meet its burden across the board. The Peraza Memorandum highlights that fact.

A. The Causation Argument Is Gone.

First of all, Peraza's challenge to the OIP's "causing" finding has essentially disappeared. The Peraza Memorandum does not even try to argue that there is a post-Hearing basis for shaping the facts on this issue. While the Peraza Memorandum tries to shoehorn the proposition that the trades conducted by the Atlanta office were "otherwise legal" into their presentation, that proposition is now offered as support for its "allocated" expenses argument. It is not offered as a separate basis for disallowing disgorgement, so even Peraza appears to accept that some form of disgorgement is appropriate here.

B. Peraza Failed to Provide any Proof to Support its Claim that its Proposed "Allocations" Were Directly Related to the Atlanta Trading.

In *Kokesh v. S.E.C.*, 137 S. Ct. 1635 (2017), the Supreme Court cited the Restatement (Third) of Restitution and Unjust Enrichment to point out the difference between disgorgement as

properly calculated, and an amount that might go beyond a correct calculation of disgorgement to include a penalty.

> Restatement (Third) § 51, Comment ***h,*** at 216 ("As a general rule, the defendant is entitled to a deduction for all **marginal costs** incurred in producing the revenues that are subject to disgorgement. Denial of an otherwise appropriate deduction, by making the defendant liable in excess of net gains, results in a punitive sanction that the law of restitution normally attempts to avoid").

Kokesh v. SEC, 137 S. Ct. at 1644–45 (emphasis added).

Courts have worked out the marginal cost concept out in great detail, because the correct cost concepts are at the heart of many antitrust law decisions. *See e.g. Cascade Health Sols. v. PeaceHealth*, 515 F.3d 883, 909 (9th Cir. 2008)("marginal cost—the cost to produce one additional unit"); *MCI Commc'ns Corp. v. Am. Tel. & Tel. Co.*, 708 F.2d 1081, 1114 (7th Cir. 1983), *cert. denied* 464 U.S. 891 (1983). Marginal costs do not include general business overhead, because overhead does not change with each additional transaction.

This general point was largely built into the securities law, even before *Kokesh.*

> "Courts in this Circuit consistently hold that a court may, in its discretion, deduct from the disgorgement amount any direct transaction costs, such as brokerage commissions, that plainly reduce the wrongdoer's actual profit," *SEC v. McCaskey,* No. 98 Civ. 6153, 2002 WL 850001, at *4 (S.D.N.Y. Mar. 26, 2002), but they have taken care to distinguish such costs from "general business expenses, such as overhead expenses, which should not reduce the disgorgement amount." *Id.* n. 6.

SEC v. Universal Express, Inc., 646 F. Supp. 2d 552, 564 (S.D.N.Y. 2009), *aff'd,* 438 F. App'x 23 (2d Cir. 2011); *see also SEC v. Merchant Capital LLC et al.,* 486 Fed. Appx. 93, *3 (11th Cir. 2012); *SEC v. Aerokinetic Energy Corp.,* 444 Fed. Appx. 382 (11th Cir. 2011); *SEC v. Warren,* 534, F.3d 1368, 1370 (11th Cir. 2008); *SEC v. Brown*, 658 F.3d 858, 861 (8th Cir. 2011); *SEC v. United Energy Partners, Inc.,* 88 Fed. App'x. 744, 746 (5th Cir.2004); *SEC v. Hughes Capital Corp.*, 917 F. Supp. 1080, 1087 (D.N.J. 1996), *aff'd* 124 F.3d 449 (3d Cir. 1997); *SEC v. Svoboda*, 409 F. Supp. 2d 331, 345 (S.D.N.Y. 2006) ("Although some courts have recognized that

brokerage commissions and other related transaction costs may be deducted from a defendant's disgorgement total, . . . general business expenses may not be deducted.").

In this case, Peraza wants to deduct "expenses" that are clearly business overhead. Perez said so in her deposition, and reaffirmed the point at trial.

> Q. All right. Are they in any way connected to the actual transactions on a transaction-by-transaction basis?
>
> A. Maybe not in a transaction-by-transaction -- they're not directly associated to a -- to a trade. To support of that trade happening, yes.
>
> Q. This is basically your allocation of what we might call overhead --
>
> A. Correct.
>
> Q. -- expenses?
>
> A. Correct.

(Hearing Transcript, at 75-76, Exhibit 2, the Deposition Transcript of Xiomara Perez, May 17, 2017, at pages 48-53.) Perez effectively confirmed her admission when she testified concerning the monthly statements that she sent Wells to confirm the right amount of money that was due:

> Q. Okay. Now, we've seen a number of expenses, Mr. Sallah's invoice, the CRD, this one, which were charged directly to Angel Oak before you sent them the money; is that right?
>
> A. Some expenses were charged directly because they're related to things that were directly for the branch as it is registrations. And that invoice for Mr. Sallah, it was related to a presentation for David Wells for one specific FINRA-related LDR.
>
> Q. Okay. Now, do you take time to try and figure out which expense were directly related to the Atlanta branch?
>
> A. On a monthly basis before -- when preparing this calculation, yes. I have to know which expenses needed to be deducted at that point.

(Hearing Transcript, at 80-81.) So when expenses were directly attributable to the Atlanta operation, Peraza **contemporaneously** charged those expenses to Wells/Angel Oak Partners before

remitting the 85% (+ or -) share to Atlanta. The expenses Peraza seeks to deduct from its disgorgement now are not just general business overhead, but they are expenses that Peraza previously determined were not "directly" related to the Atlanta operations.[1]

Moreover, beyond these admissions, Peraza has failed to explain how the expenses it seeks to deduct have any direct connection to the trades in question. For 2012, Perez allocated $242,692 of "Professional Fees" as Atlanta related expenses, when the total revenue from the Atlanta trading was $2,608,176.30. (*See* Exhibit 3, the first summary page.) But for 2014, she allocated only $30,000 for "Professional Fees" as Atlanta related expenses, when total revenue from the Atlanta trading was $3,104,657. (*Id.*) Clearly, the "Professional Fees" did not relate to the Atlanta trading activity in any direct way. Moreover, in 2013, Perez allocated $68,900 as Atlanta related expenses for "Accounting." (*Id.*) But in 2014, when total revenue from the Atlanta trading had increased barely 3%, Perez allocated $114,573 for "Accounting" expenses allegedly related to the Atlanta trading – an increase of 66% in this allocation. (*Id.*) Again, there is no arithmetically direct relationship between these "allocated" expenses and the Atlanta trading.

This cries out for some form of substantiation. At the Hearing, Peraza provided none. There was no contemporaneous allocation, or accounting record to justify the numbers Perez created:

> where a defendant's record-keeping or lack thereof has so obscured matters that calculating the exact amount of illicit gains cannot be accomplished without incurring inordinate expense, it is well within the district court's discretion to rule that the amount of disgorgement will be the more readily measurable proceeds received from the unlawful transactions. *See CFTC v. Am. Bd. of Trade, Inc.*, 803 F.2d 1242, 1252 (2d Cir.1986).

Calvo, 378 F.3d at 1217–1218.

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[1] It is true that Perez broadly asserted that the overhead expenses were directly related to the Atlanta operation, but this was not supported by any explanation, and when she was questioned about the details, she made clear that direct expenses were deducted contemporaneously. (*Compare* Hearing Transcript at 68 with Hearing Transcript at 75-76, 80-81.)

Furthermore, to the extent that Peraza seeks to rely on Perez's educated guesses, the law is clear that "unqualified, conclusory statements are insufficient" to meet a party's evidentiary burden. *SEC v. MAM Wealth Mgmt., LLC*, No. CV1102934SJOJCX, 2012 WL 13008348, at *3 (C.D. Cal. July 2, 2012). A good illustration of this principle is the recently decided Eleventh Circuit case, *Pier 1 Cruise Experts v. Revelex Corp.*, No. 17-13956, 2019 WL 3024618 (11th Cir. July 11, 2019). This was a breach of contract case involving a Brazilian travel agency and a webpage designer. The travel agency claimed damages, but supported the claim based solely on the testimony of its "financial manager," Mariana Peres. Peres came up with her own estimates of both the increase in revenue and expenses that would have occurred absent the alleged breach by the webpage designer. The District Court rejected her estimates, and the Court of Appeals affirmed, stating:

> [The] lost-profits calculation was too speculative . . . [and] legally insufficient. The district court correctly concluded that Peres seemed to have "decided to pick a number out of thin air" . . . Peres's calculation of Pier 1's increased expenses—10%—was also impermissibly speculative. . . . her choice to peg the expense increase at 10% also seems to have come out of "thin air."

Pier 1 Cruise Experts, 2019 WL 3024618, at *6. *See also Josendis v. Wall to Wall Residence Repairs, Inc.*, 662 F.3d 1292, 1318 (11th Cir. 2011) ("such 'evidence,' consisting of one speculative inference heaped upon another, was entirely insufficient"); *Pushko v. Klebener*, 399 Fed. App'x 490, 494 (11th Cir. 2010) ("damages evidence was too speculative").

In this case, there was no explanation offered at the Hearing for how Perez derived her estimates of how much expense to "allocate" to the Atlanta trading. As shown above, the Perez allocations do not seem to fit any mathematical pattern, and there is nothing in the record that even suggests the existence of a methodology for the allocations. As in *Pier 1 Cruise Experts*, Perez seems to have just "pick[ed] a number out of thin air."

C. The "Legitimate Business Expense" Argument Is a Red Herring.

The Peraza Memorandum creates some confusion on the issue of what may constitute an appropriate expense reduction from disgorgement. It cites to *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109 (9th Cir. 2006) and several other cases that cite *Wallenbrock* to the effect that the issue is whether the illegal activity took place as part of an otherwise legitimate business. (*See* Peraza memorandum, at 4-5, Item 13, and 7-9.) If so, the argument seems to be that certain expenses of that legitimate business may be deductible from disgorgement.

First of all, *Wallenbrock* disallowed all of the expenses claimed in that case without any detailed assessment of any particular expense. None of the other cases cited by Peraza actually includes an analysis of how you would separate legitimate from illegitimate expenses. The cited cases that separate expenses by category appear to identify deductible expenses as ones directly related to the illegal acts. *See, e.g. SEC v. Thomas James Assocs., Inc.*, 738 F. Supp. 88, 94 (W.D.N.Y. 1990)("In determining the proper amount of restitution, a Court may consider as an offset the sums which a defendant paid to effect [an illegal] transaction"); *SEC v. Gold Standard Mining Corp.*, No. CV 12-5662 JGB (CWX), 2016 WL 6892101 (C.D. Cal. May 26, 2016)(allowing a deduction of travel expenses from the overall amount received by an audit firm as part of a fraudulent filing case).

Peraza also cites a case, *SEC v. Aerokinetic Energy Corp.*, No. 8:08-CV-1409-T-27TGW, 2010 WL 5174514 (M.D. Fla. Sept. 10, 2010) that initially appears to follow *Wallenbrock*, but *Aerokinetic* ultimately held that:

> Even if an offset of expenses were appropriate, the defendants have failed to substantiate the alleged expenses. All that the defendants have produced is a conclusory one-page spreadsheet purporting to identify expenses in the amount of $538,518.49 (Doc. 59–7, p. 2). The spreadsheet is unsworn and unexplained. Moreover, it is not accompanied by any backup documentation.

Id., at *4. This sounds very much like what Peraza offered in this case through Perez's worksheet.

Finally, it appears that courts in the Ninth Circuit have rejected the interpretation of *Wallenbrock* promoted by Peraza:

> Defendants' argument that the disgorgement amount should be reduced by amounts paid for legitimate business expenses has been rejected by the Ninth Circuit. *SEC v. Aqua Vie Beverage Corp.*, No. CV 04–414–S–EJL, 2008 WL 1914723, at *2 (D. Idaho Apr. 29, 2008) (citing *First Pac. Bancorp*, 142 F.3d at 1192). Martinez and Sanchez, as President and Chief Financial Officer of the Fund, respectively, had the full benefit of the entire amount fraudulently raised from investors. How they chose to spend that amount—whether on accounting services, asset management fees, or to reimburse themselves for previously incurred expenses—is irrelevant for purposes of determining the amount of disgorgement. *See JT Wallenbrock & Assocs.*, 440 F.3d at 1116 ("The manner in which [defendants] chose to spend the illegally obtained funds has no relevance to the disgorgement calculation because ... the defendants had the full benefit of the entire $253.2 million fraudulently raised from investors.").

SEC v. MAM Wealth Mgmt., LLC, No. CV1102934SJOJCX, 2012 WL 13008348, at *3 (C.D. Cal. July 2, 2012).[2]

As a last point, the Peraza Memorandum relies heavily on a case called *SEC v. Hall*, No. 15-cv-234890, 2017 WL 1504025 (S.D. Fla. April 13, 2017). The Division cannot find the quote that Peraza cites in that report. (*See* Peraza Memorandum at 7.) But the order found at that WestLaw cite indicates that the District Court ultimately *reversed* its denial of the SEC's request for disgorgement on reconsideration.

> it was reasonable for the SEC, in calculating Hall's profits from the three transactions, to decline to offset with the value of any posted collateral. . . . As clarified in the present Motion and Reply, and on reconsideration, the SEC has reasonably traced all the profits it proposes to disgorge back to Hall's fraudulent actions and there is no evidence those profits include legitimately earned monies.

[2] It is also noteworthy that the holding in *Kokesh*, which endorses the direct marginal cost approach advocated by the Division here, leaves no room for a "legitimate" versus "illegitimate" distinction as an analytical tool for calculating disgorgement. *Kokesh*, 137 S. Ct. at 1644–45.

SEC v. Hall, 2017 WL 3635108, at *3 (S.D. Fla. June 29, 2017), *aff'd sub nom. SEC v. Hall*, 759 Fed. App'x 877 (11th Cir. 2019). Moreover, as is true in this case, the defendants in *Hall* failed to meet their burden of proof on the theory they advanced. If there are no expenses traceable directly to the illegal activity, then the profits on the illegal activity are the correct measure of disgorgement. In this case, that number is $1,180,487.98.

III. A FIRST-TIER MAXIMUM CORPORATE PENALTY IS APPROPRIATE.

A penalty is appropriate against Peraza. Peraza facilitated the illegal securities trading by Angel Oak Partners over a four-year period, made a substantial amount of money by doing so, and has a regulatory record showing distain for its obligations as a broker-dealer. Compared to similar cases, the Division's request for a First Tier maximum penalty of $75,000 is appropriate for Peraza on these facts. (Exchange Act Section 21B(b)(1).) As noted in the Division's original Post-Hearing Memorandum, the Division could be seeking a penalty equal to the full amount of unjust enrichment. The request for $75,000 under these circumstances is entirely reasonable.

As explained in the Division's original submission, three factors from the applicable statutory and *Steadman* factors support assessing a first-tier penalty against Peraza. First of all, the illegal behavior involved 900 illegal trades, and took place over a substantial period of time – from March of 2010 through the end of 2014. This is surely "recurrent" behavior. Second, Peraza received over $1.5 million in total unjust enrichment from this activity, almost $400,000 of which cannot be recovered in disgorgement because of *Kokesh*. This amount is greater than many other cases in which unjust enrichment was cited as a factor in assessing a penalty. Third, Peraza is a recidivist. The Division entered three prior determinations by the NASD and FINRA showing prior regulatory problems at Peraza. (Exhibits 13, 14, and 15.)

The Peraza Memorandum only addresses one of these factors – the recurrent nature of the offenses. But Peraza's only argument on that matter is that the conduct "was isolated in that it related to one branch of Peraza." (*See* Peraza Memorandum at 11.) The word "isolated" can of course have both a temporal and geographic meaning. But the meaning at issue in the *Steadman* factors is not the geographic meaning. Otherwise, any firm with but one office could never be a "recurrent" violator. There is nothing in the design of the law to support such an idea.

Peraza's only other point is that it does not run afoul of *every* penalty factor. But there is no requirement that a respondent tick every box in order to deserve a penalty. A case involving market timing is instructive. There were two registered representatives (salesmen) in two separate offices of A.G. Edwards. They engaged in market timing transactions in mutual funds for favored clients over an eighteen month period. They used a variety of manipulations to conceal their actions. Both were found liable for fraud. In addition, their two supervisors were found liable for failure to supervise. The registered representatives engaged in serious misconduct that harmed the mutual funds' shareholders, they had a high degree of scienter, they made individual profits, and at least one of them displayed no acknowledgement of his wrongdoing. The reported case determined remedies for only one of the salesman, but both of the supervisors. The salesman received four third-tier penalties, in addition to disgorgement and other injunctive relief. One of the supervisors (of the salesman still in the case) received four second-tier penalties, no finding of disgorgement, and injunctive relief. The other supervisor (of the previously settled salesman) received six first-tier penalties, no disgorgement, and injunctive relief. *In the Matter of Thomas C. Bridge James D. Edge & Jeffrey K. Robles*, Release No. 9068 (Sept. 29, 2009), *aff'd Robles v. SEC,* 411 Fed. App'x 337, 338 (D.C. Cir. 2010)("the Commission's factual findings were well-supported by substantial evidence.") The variation in

the penalties related to the fact that the supervisors had not themselves engaged in egregious behavior, had received no financial benefit, and were reckless in one case, negligent in the other. There was no mention of prior regulatory issues for any of them.

It is thus undeniable that the Commission can and does balance the statutory and *Steadman* factors in deciding penalties, and that there is absolutely no requirement that someone needs to hit every factor in order to merit a first-tier penalty. *See e.g. In the Matter of David B. Havanich, Jr., et al.*, Release No. 935, 2016 WL 25746 *11 (Jan. 4, 2016) ("Fraud and previous violations are absent from the instant case. However, Respondents' violations involved a reckless disregard of a regulatory requirement and resulted in unjust enrichment and harm to others. Deterrence also requires penalties."); *In the Matter of Jantzen*, Release No. 472, 2012 WL 5422022 (Nov. 6, 2012) ("a persuasive showing with respect to **some** of the *Steadman* factors"[*emphasis added*]); *In the Matter of Ran H. Furman*, Release No. 459A, 2012 WL 1980909 (June 20, 2012) (ALJ gave an attorney a seven-year bar from appearing in front of the Commission, finding that a temporary bar more appropriate than the Division's request for a permanent bar, stating that "[m]ost *Steadman* factors weigh in favor of a permanent bar, but two -- egregiousness and the isolated nature of the infraction -- weigh in favor of leniency.")

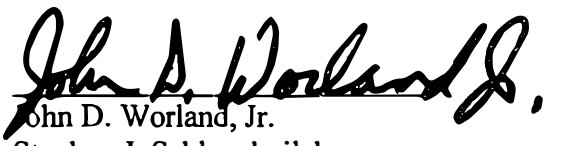
For all of these reasons, the Division could seek a penalty equal to the total amount of Peraza's disgorgement. Instead, the Division seeks only a first-tier statutory penalty of $75,000. The Division has made a sufficient showing to support this award.

CONCLUSION

For all the above reasons, the Division requests that Peraza be ordered to pay disgorgement of $1,180,487.98, prejudgment interest on that amount of $245,322,60, and a first-tier penalty of $75,000, for a total of $1,500,810.58.

Dated: July 15, 2019

Respectfully submitted,



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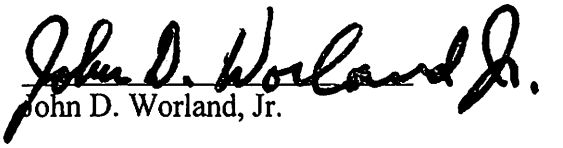
CERTIFICATE OF WORD COUNT

I hereby certify that the above Memorandum has fewer than 7,000 words.



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CERTIFICATE OF SERVICE

I hereby certify that I served true copies of the Division of Enforcement's Reply Memorandum of Law by e-mail on the following on this 15th day of July, 2019, and filed the original and three copies with the Secretary's Office:

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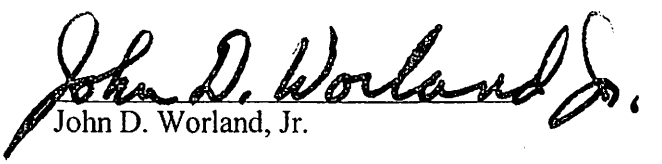

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