SECURITIES AND EXCHANGE COMMISSION
ADMINISTRATIVE PROCEEDING

In re RANDALL S. GOULDING,	)	File No. 3-19697
Respondent	)	

GOULDING'S PETITION TO LIFT THE TEMPORARY PRACTICE SUSPENSION, AND REQUEST FOR A HEARING

Pursuant to Rule 102(e)(3)(ii) of the Securities and Exchange Commission's Rules of Practice, respondent Randall S. Goulding, by his undersigned attorney, petitions the Commission to lift the *ex parte* temporary practice suspension issued on February 7, 2020, and to set the matter down for a hearing.

At the time Goulding learned of the order, he was representing several clients in an SEC enforcements matter before the Chicago office, and two clients in regulatory matters before the Division of Corporate Finance (National) office. Goulding immediately directed those clients to retain other attorneys.

A. INTRODUCTION

The temporary suspension is based on Findings of Fact and Conclusions of Law filed by the Hon. Jeffrey T. Gilbert, United States Magistrate Judge, on October 25, 2019 in *Securities and Exchange Commission v. The Nutmeg Group, LLC, et al.*, Case No. 09-cv-1775 (N.D. Ill.) (sometimes, "the Findings and Conclusions").

As the District Court's Findings and Conclusions indicate, Goulding is a defendant in the *SEC v. Nutmeg* case. Nutmeg, a registered investment advisor, was Goulding's company, and it managed and advised several investment pools organized as limited partnerships (sometimes, "the Funds"). Following ten years of litigation and a bench trial that lasted more than two

weeks, Goulding was found to have violated several sections of the Investment Advisors Act of 1940, 15 U.S.C. §80b-1 *et seq.* Magistrate Judge Gilbert also imposed several remedies, most notably an order that Goulding disgorge, pursuant to the federal court's so-called "equitable" authority in SEC enforcement actions, what the Findings and Conclusions characterize as $642,422 in "ill-gotten gains." As explained below, that remedy was based on an incorrect finding that Goulding misappropriated assets belonging to the Funds managed and advised by Nutmeg.

B. <u>SUMMARY OF GOULDING'S POSITION</u>

Temporary suspensions of a professional's right to practice before the SEC of course derive from the regulatory authority to enter a final disbarment order or lesser sanction under SEC Rule 102(e)(1)(iii). However, as applied to Goulding's case, SEC Rule 102(e)(1)(iii) is unconstitutionally vague since the rule does not clearly identify the *mens rea* that the Commission must prove before the penal or quasi-criminal penalty remedy of disbarment and/or a final suspension can be imposed. (Point I-(a), *infra*.)

Also, a penalty under SEC Rule 102(e)(1)(iii) cannot be based upon the District Court's Findings and Conclusions which were made pursuant to the preponderance of the evidence standard applicable in civil cases. Instead, the sort of penal or quasi-criminal remedy the Commission is seeking here would have to be based upon *de novo* findings made pursuant to a clear and convincing evidence standard applicable to professional discipline and disbarment matters. (Point I-(b), *infra*.)

Further, the obey-the-law injunction imposed by the District Court and cited in the temporary suspension order is invalid because it fails to track the statutory language and fails to

inform Goulding of what conduct is prohibited, and therefore cannot by itself justify the continuation of the temporary suspension order prior to a hearing. (Point II, *infra*.)

In a *de novo* hearing on the merits of the Commission's allegations, Goulding will show that the District Court's finding that he misappropriated $642,422 from investors is wrong. That finding was based on a summary that the SEC submitted at trial (PX43) purportedly showing that Goulding had received $642,422 more in transfers or benefits from Nutmeg than he had made in transfers to Nutmeg. However, that summary does not reflect Goulding's entitlement to $869,749.99 in non-contingent management fees based on the securities offerings conducted by Nutmeg. (Point III, *infra*.)

Relatedly, the District Court's Findings and Conclusions do not indicate that those securities offerings that generated those fees were fraudulent, and all the misconduct attributed to Goulding was subsequent to and apart from the offerings. Therefore, under the relevant case law, the non-contingent management fees were not ill-gotten gains. (Point IV, *infra*.)

Next, the District Court's finding that Goulding had improperly valued assets under his management is not a basis for any disciplinary action, because Goulding either correctly applied the FASB Guidelines, or if he erred in doing so, that error was merely negligent. (Point V, *infra*.)

Finally, a *de novo* hearing will establish that Nutmeg's transfer of Fund assets to affiliates who invested those assets for the benefit of the Funds was a proper use of so-called "special purpose vehicles," and it was entirely proper under the SEC's own "Guidance" releases, to continue to attribute those assets to the Funds in the account statements sent to investors. (Point VI, *infra*.)

C. BACKGROUND

Randall Goulding graduated from University of DePaul College of Law in 1978 and was admitted to the Illinois bar that year. Following law school he worked for approximately ten years in a small law firms, and then became a solo practitioner. His principal area practice area was tax law.

In 1992 Goulding was convicted of a conspiracy, mail fraud and currency violations based on charges resulting from a federal sting operation. That conviction was upheld on appeal in 1994. *United States v. Goulding*, 26 F.3d 656 (7th Cir. 1994). As a result of the conviction he was suspended from practicing law for four years. The suspension was concluded on June 24, 1998. *In re Randall S. Goulding*, 91CH0208 (June 24, 1998). A *certiorari* petition requesting the United States Supreme Court review the conviction as unsuccesssful, even though it was supported by an *amicus* brief filed by the National Association of Criminal Defense Lawyers, and authored by retired Illinois State Court Judge Robert Mackey and retired U.S. District Court Judge George N. Leighton.

Following his suspension, Goulding resumed the practice of law, working, *inter alia*, for Paradigm Group, LLC, an investment firm, first as an attorney and then as a financial consultant.

In 2003, Goulding founded The Nutmeg Group, LLC, a company in which he was a 99 percent owner and the managing member.

Following a business model that Goulding had become familiar with at Paradigm, Nutmeg raised money from investors who became limited partners in "investment pools," for which Nutmeg acted as general partner and investment advisor.

The bulk of the assets Nutmeg caused these investment pools to acquire were convertible

debentures issued by small, financially distressed companies. Goulding was familiar with these types of securities from his time at Paradigm. The debt evidenced by a floating convertible debenture can be "converted" to stock in the public company according to an agreed formula. Typically, portions of the debt are converted sequentially. The conversion formula can either be fixed or vary with the trading price of the public company's stock during a recent "look-back period." Debentures with variable formulas are called "floating convertible debentures." While floating convertible debentures are labeled as risk-creating transactions, that is a reference to the risk they impose on the issuer, not the investor. That is, they minimize risk on the part of the investor, and shift the risk to the public company issuer and away from the investor. See Susan Chaplinsky and David Haushalter, "Financing under Extreme Uncertainty: Evidence from PIPEs" 31 (working paper), University of Virginia (2003).

The shift of risk to the issuer (and away from the investors) is accomplished by tying the conversion formula to recent trading prices. For example, *SEC v. Parnes*, 2001 WL 1658275 (S.D.N.Y., Dec. 26, 2001) rejected a claim that a decline in the stock price was "adverse" to the holder as:

> * * * unpersuasive because the value of the debentures at issue here was not tied to the stock price: the terms of the debentures guaranteed a 25% discount upon conversion whether the stock price was high or low, and as the stock price fell, the number of shares obtained upon conversion increased, so the holders' economic interest remained the same.

Id. at *6 (emphasis added).

Similarly, Hillion and Vermaen, "Death Spiral Convertibles," 71 *Journal of Financial Economics* 381 (2004), recognizes that:

> [B]y converting and selling 100 shares at [the hypothesized] $12.5 [price during the look back period less the contractual 20 percent discount], the investor

> can earn a risk free rate of return of 25%[.] . . . . [T]his return is independent of the stock prices: if the stock prices had been $1.25, the investor could have sold 1000 shares and obtained the same 25% return on investment. As a result, a very risky mining company can issue a financial security that is risk-free, . . ."

Id. at 82 (emphasis added).

Originally, because of its small size (both in terms of the number of clients and the value of assets under management), Nutmeg was not required, under the Investment Advisers Act, to register with the SEC or create separate accounts for each client – *i.e.*, each investor pool is a client under the Investment Advisors Act of 1940. However, as of 2007, Nutmeg had grown to the point where it was required to – and did – register, and its registration became effective in May of that year. Unfortunately, however, Nutmeg registered before it had properly segregated accounts (for each investment pool) or installed sufficient records-keeping practices. As a result, an examination by an SEC compliance unit resulted in a letter notifying Nutmeg of certain deficiencies in operations, relating to records-keeping, account segregation and internal controls.

E. THE SEC ENFORCEMENT ACTION THAT RESULTED IN THE DISTRICT COURT'S FINDINGS AND CONCLUSIONS

Despite Nutmeg's effort to comply with recommendations in the deficiency letter, the SEC commenced the enforcement action on March 23, 2009, alleging violations of the 1940 Act. When the case was filed in 2009, District Court Judge William Hibbler entered an injunction prohibiting Goulding from operating Nutmeg or managing the Funds, and eventually a federal equity receiver, Leslie Weiss, Esq., assumed control of Nutmeg and the Funds.

Thereafter Goulding returned to the practice of law, focusing on transactional work, and devoted a substantial amount of time to defending the enforcement action. Eventually, due to an inability to continue to pay lawyers, he acted *pro se* between 2011 and 2017. It was not until

shortly before trial that he was able to retain counsel.

In its enforcement action, the SEC brought several statutory negligence claims against Nutmeg and Goulding, such as the failure to properly maintain records and segregate accounts. However, the main point of contention was the SEC's claim that Nutmeg had overvalued the Funds' assets, causing it to disseminate incorrect account statements. Since part of Nutmeg's compensation (a portion of its "carried interest" allocation) was tied to the value of the assets under management, the SEC also charged that this alleged overvaluation allowed Nutmeg and Goulding to receive excessive compensation, which the SEC sought to have them disgorge.

In 2016, the SEC obtained partial summary judgment on the inadequate record-keeping and other statutory negligence claims. *SEC v. Nutmeg* Dkt. No. 795. (Goulding briefed the summary judgment and several motions *in limine* himself, despite having little to no experience in financial litigation.)

The claims relating to the valuation issue – excessive compensation and misleading account statements – were tried before Magistrate Gilbert between January 16 and January 31, 2018. Goulding was principally represented in this action by Eric Berry, a New York-based securities litigator, who appeared in the case shortly before trial (and also represents Goulding in the instant administrative proceeding.)

On October 25, 2019, Judge Gilbert filed Findings of Fact and Conclusions of Law. Paragraph 37 of those findings states:

> 37. Randall's violations of the Advisers Act were material, in that he: (a) overstated the valuation of Fund assets and investments; (b) assessed fees from the Funds payable to Nutmeg based on overstated asset valuations; (c) misappropriated client and investor assets from Nutmeg's commingled bank accounts for his own personal benefit; and (d) failed to disclose to investors the overstatement of investment assets and fees, and the misappropriation of investor

assets.

Items (a), (c) and (d) in paragraph 37 are based on a finding that Nutmeg (and Goulding) overstated the value of the assets held by two investment pools, Mercury Fund and Stealth Fund. Item (c) finds that he misappropriated assets. The misappropriation finding is wrong. The overvaluation finding, at worst, is a rejection of Goulding's apparently correct (and, at minimum, colorably correct) view about how Financial Accounting Standard Board (FASB) guidance should be applied to convertible debt securities.

The commingling discussed by Judge Gilbert was not the commingling of the funds of law clients, instead, it involved the commingling of Nutmeg's money with that of the investor pools. SEC Rule 206(4)(2)(a) provides that custody requirements are met if cash and certificated securities are held at a qualified institution, such as a bank or brokerage, which of course Nutmeg did. The rule does not by its terms require separate accounts for each client since it can be satisfied if:

> (1) . . . A qualified custodian maintains those funds and securities -
> (i) In a separate account for each client under that client's name; or
> (ii) In accounts that contain only your clients' funds and securities, under your name as agent or trustee for the clients.

Id. (Emphasis added.)

Of course, a general partner, like the limited partners, makes a capital contribution to the limited partnership, which will be deposited in the same account that holds the limited partners capital contributions. Goulding thus correctly and reasonably believed that, since Nutmeg was a general partner and investor, it was permitted have its own cash holdings in the investment pools (including both its capital contribution and accreted compensation for management services) placed in the same qualified custodian accounts where the limited partners' capital contributions

to those entities were deposited. This is not forbidden by the terms of the "custody rule." See Edward C. Laurenson, "Frequent Compliance Issues under the SEC's Custody Rule under the Investment Advisers Act," Practical Compliance & Risk Management for the Securities Industry, p. 19 (Sept./Oct. 2013). However, because Nutmeg did not have an audit for the year in which it became registered, it was not permitted to rely on Rule 206(4)(2)(a)(1)(ii). Goulding did not realize this at the time, and any inference of scienter should be rejected.

The District Court's Findings and Conclusions never state that the legal violations it attributes to Goulding were intentional as opposed to reckless. *Id.*, p. 49, ¶31 ("intentionally or recklessly); ¶32 ("intentionally or recklessly"). Aso, while the District Court's Findings and Conclusions contain an obey-the-law injunction, that injunction provides no guidance as to what particular conduct is prohibited. *Id.*, p. 51, ¶41 ("Based on the evidentiary record, and an analysis of the relevant factors, it is reasonably likely that Randall will engage in future violations of the law and should be permanently enjoined."); ¶43 ("Accordingly, Randall should be enjoined permanently from violating the provisions of the Advisers Act which are at issue in this case.")

E. POINTS AND AUTHORITIES

Point I

Rule 102(e)(1)(iii) Is a Constitutionally Improper Basis for the Imposition of Penal Sanctions

Rule 102(e)(1)(iii) provides that the Commission may bar a professional from practicing before it if he has been previously been found "to have to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder." All that is required is a willful violation of the securities laws; no

further character or fitness review is required. In other words, Rule 102(e)(1)(iii) means that a securities law violation may result in an *automatic* disbarment or suspension of the privilege of practicing before the Commission.

Professional disbarment and securities industry bars are penal remedies. *Saad v. SEC*, 873 F.3d 297, 306 (D.C. Cir. 2017) (Kavanaugh, J., concurring) ("SEC must justify expulsions or suspensions as punitive."); *In re Ruffalo*, 390 U.S. 544, 551, 88 S.Ct. 1222, 1226 (1968) (disbarment proceedings are "of a quasi-criminal nature").

Now-Justice Kavanaugh's concurring opinion in *Saad* was based on the natural implication of *Kokesh v. SEC*, 137 S. Ct. 1635 (2017). He concluded:

> The Supreme Court's reasoning in Kokesh was not limited to the specific statute at issue there. Like disgorgement paid to the Government, expulsion or suspension of a securities broker does not provide anything to the victims to make them whole or to remedy their losses. Therefore, in light of the Supreme Court's analysis in *Kokesh,* expulsion or suspension of a securities broker is a penalty, not a remedy.

Saad v. SEC, *supra*, 873 F.3d at 305.

Because attorney disciplinary proceedings are "quasi-criminal in nature," an "an attorney is entitled to procedural due process . . . in disbarment or suspension proceedings." *Dailey v. Vought Aircraft Co.*, 141 F.3d 224, 229 (5th Cir. 1998).

A. Rule 102(e)(1)(iii) Is Void for Vagueness as A Penal Remedy Since it Does Not Adequately Identify the *Mens Rea* Required for Penal Sanctions

Because Judge Gilbert found only that Goulding's securities law violation were either "intentional or reckless," his Findings and Conclusions ecessarily establish only recklessness. *Id.*, p. 49, ¶¶31 and 32.

Rule 102(e)(1)(iii) is void for vagueness, as applied in this case, since it does not make

clear whether a reckless violation of the law is a sufficient *mens rea* to sustain disbarment or a suspension.

The vagueness doctrine is an aspect of procedural due process. The Fifth Amendment guarantees that an individual's life, liberty or property cannot be taken "without due process of law." Goulding's right to practice law before the SEC is, of course, a protected property interest. Under the due process clause, "[A] statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law." *Connally v. General Constr. Co.*, 269 U.S. 385, 391, 46 S.Ct. 126, 127 (1926).

The vagueness doctrine imposes a "requirement of clarity in regulation [that] is essential to the protections provided by the Due Process Clause of the Fifth Amendment." *F.C.C. v. Fox Television Stations, Inc.*, 567 U.S. 239, 253, 132 S.Ct. 2307, 2317 (2012).

As the Washington Supreme Court summarized the law, in holding an attorney disciplinary rule unconstitutionally vague:

> Courts have long recognized that disbarment is "penal in its nature" and subject to the rule of lenity. *Moutray v. People*, 162 Ill. 194, 198, 44 N.E. 496 (1896) (holding statutes authorizing disbarment must be "strictly construed, and not extended by implication to things not expressly within their terms"). *See also Ruffalo*, 390 U.S. at 550–51, 88 S.Ct. 1222 ("Disbarment ... is a punishment or penalty imposed on the lawyer" involving "adversary proceedings of a quasi-criminal nature."); *Charlton v. Fed. Trade Comm'n*, 177 U.S.App. D.C. 418, 543 F.2d 903, 906 (1976)); *In re McBride*, 602 A.2d 626, 640–41 (D.C.1992) (applying rule of lenity to statute governing disbarment). The same holds for all other sanctions. "Because attorney suspension is a quasi-criminal punishment in character, any disciplinary rules used to impose this sanction on attorneys must be strictly construed resolving ambiguities in favor of the person charged." *United States v. Brown*, 72 F.3d 25, 29 (5th Cir.1995); *In re Thalheim*, 853 F.2d 383, 388 (5th Cir.1988).

In re Disciplinary Proceeding v. Haley, 156 Wash.2d 324, 349, 126 P.3d 1262, 1274 (2006).

See generally: Manning v. Caldwell, 930 F.3d 264, 272 (4th Cir. 2019) ("laws that nominally impose only civil consequences warrant a 'relatively strict test' for vagueness if the law is 'quasi-criminal' and has a stigmatizing effect").

The vagueness problem for Rule 102(e) lies in its use of the term "willfully" to define the *mens rea* that must be shown before disbarment or suspension. The term is universally regarded as having a meaning that changes depending on its context. *United States v. Zeeze,* __ F.Supp. __ , __ , 2020 WL 554803, *5 (D.D.C., Feb. 4, 2020) ("'Willfully,' . . . 'is sometimes said to be a word of many meanings whose construction is *often dependent on the context in which it appears*'" (emphasis added, quoting *Bryan v. United States*, 524 U.S. 184, 191, 118 S.Ct. 1939, 1944-1945 (1988)).

For civil securities law violations, "willfulness" undoubtedly does include reckless disregard of the law. *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1039-40 (7th Cir.), *cert. denied*, 434 U.S. 875, 98 S.Ct. 224 (1977) (equating recklessness and "willful fraud").

However, the Supreme Court recognizes that, while the meaning of "willful," in a purely civil case includes "reckless disregard of the law," * * *

> It is different in the criminal law. When the term "willful" or "willfully" has been used in a criminal statute, we have regularly read the modifier as limiting liability to knowing violations.

Safeco Ins. Co. of America v. Burr, 551 U.S. 47, 57 & n.9, 127 S.Ct. 2201, 2208 & n.9 (2007).

In a penal or quasi-criminal proceeding, such as this, the meaning of "willfully" that is used in criminal cases (rather than civil cases) should apply. That is, an intentional violate of the law should be required before a disbarment or suspension is ordered, rather than merely deliberate conduct and reckless disregard of the law.

There is no clarity as to whether the term "willfully," as used in Rule 102(e), includes the reckless violations of the law that Goulding was found to have committed. In fact, the District of Columbia Circuit has repeatedly sustained "challenges" to "Rule 102(e)(1) sanctions" based on the Commission's "failure to provide standards or notice as to the possibility that negligent or reckless conduct could fall within [its] ambit." *Altman v. S.E.C.*, 666 F.3d 1322, 1328 (D.C. Cir. 2011) (citing *Marrie v. SEC*, 374 F.3d 1196, 1202 (D.C. Cir. 2003); *accord: Checkosky v. SEC*, 139 F.3d 221 (D.C.Cir.1998). *See also: Checkosky v. SEC*, 23 F.3d 452, 458 (D.C. Cir.1994)) (Silberberg, J.. plurality opinion) ("The Commission . . . does not specify the state of mind both necessary and sufficient to constitute a violation in light of its past precedents.")

In the first *Checkofsky* case, Judge Silberberg's opinion stated:

> I think the Commission must choose its standard and forthrightly apply it to this case. Given the enormous impact on accountants—and lawyers—that the Rule has, and in fairness to petitioners, the Commission must be precise in declaring the standard against which petitioners' conduct is measured and exactly why that conduct violated the standard.

Id., 23 F.3d at 462.

Nevertheless, following the *Checkosky* rulings, the SEC clarified that reckless conduct was sufficient to sustain a bar or suspension, but *only* in the case of accountants charged with "improper professional conduct" under Rule 102(e) (1)(ii). Amendments to Rule 102(e) of the Commission's Rules of Practice, Fed. Sec. L. Rep. (CCH) ¶ 86,052, at 80,844 (Oct. 19, 1998).

In other types of Rule 102 proceedings – such as those involving attorneys or allegations of securities law violations – the Commission did not clarify whether reckless disregard of the

law is a sufficient *mens rea* to justify disbarment or suspension, and the vagueness defect identified in the *Checkosky* decisions still exists.

According, the allegation that Goulding should be disbarred or suspended based upon reckless securities law violations should be dismissed since the Rule 102(e)(1)(iii) is unconstitutionally vague as applied to that level of *scienter*.[1]

B. The Automatic Preclusive Effect that Rule 102(e)(1)(iii) Accords to Prior Judicial Findings of Securities Law Violations Means that It Should Only Be Applied Where the Burden of Proof in the Prior Proceeding Was Established Under a Clear and Convincing Standard

As noted, under Rule 102(e)(1)(iii), an established securities law violation may result in an automatic disbarment or suspension, without further character or fitness review.

The standard of proof required in attorney disciplinary proceedings is not the preponderance of evidence standard applicable in civil cases, but the higher "clear and convincing standard" *In re Karavidas*, 376 Ill. Dec. 413, 431, 999 N.E.2d 296, 314 (2013) (". . . [W]e hold that professional discipline may be imposed only upon a showing by clear and convincing evidence that the respondent attorney has violated one or more of the Rules of Professional Conduct."); *In re Mitchell*, 727 A.2d 308, 313 (D.C.1999) ("It is Bar Counsel's burden to establish by clear and convincing evidence that respondent violated the Rules of Professional conduct.").

Because Rule 102(e)(1)(iii) permits automatic disbarment or attorney discipline based

[1]Goulding is aware that *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) held, in this context of industry (rather than practice bars) that "willfulness" in this context means intentionally or recklessly committing an act that constitutes a violation of the securities laws. However, Wonsover predates Kokesh, and Justice Kavanaugh's concurrence in *Saad*. Also, practice bars are clearly penal in nature, even if industry bars are not. *See* Point I-(b), *infra*.

solely on judicial findings, it should not do so based solely on prior judicial findings where the prior findings were based on the preponderance of evidence standard. *In re Gygi*, 273 Or. 443, 448 541 P.2d 1392, 1395 (2000) (". . . [T]here is a higher standard of proof in disciplinary actions than that which obtained in the federal securities case. Collateral estoppel is not applicable when the standard of proof in the second proceeding is greater than that which applied in the first."). As stated in *Attorney Grievance Commission of Maryland v. Robert Harley Bear*, 362 Md. 123, 763 A.2d 175 (2000):

> Jurisdictions that have dealt with the precise issue presented by this case almost uniformly refuse to give preclusive effect to issues decided in a civil case under a preponderance of the evidence standard in a subsequent attorney discipline proceeding. Stated otherwise, the other jurisdictions which have encountered this issue have refused to apply offensive collateral estoppel in an attorney discipline proceeding unless the burden of proof in the prior proceeding equaled or exceeded the clear and convincing burden which governs disciplinary proceedings.

362 Md. at 134, 763 A.2d at 181 (summarizing cases).

Here, the findings made by Judge Gilbert were made only pursuant to the preponderance of evidence standard. *S.E.C. v. Seghers*, 298 Fed.Appx. 319, 323 (5th Cir. 2008) (violations of the Investment Advisers Act must be proven by a preponderance of the evidence); *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 545 F.Supp. 1314, 1369 (S.D.N.Y. 1982) (preponderance of the evidence standard applies to all claims for violation of the anti-fraud provisions of the federal securities laws).

For these reasons, findings made pursuant to the preponderance of evidence standard in a prior federal securities cannot be used offensively in a subsequent attorney disciplinary proceeding. Thus, in proceedings under Rule 102 (e)(1)(iii), prior adjudications of securities law violations can be accorded collateral estoppel effect only if they were made pursuant to a clear

and convincing (or higher) standard. *Cf. In re Owens*, 125 Ill.2d 390, 126 Ill.Dec. 563, 532 N.E.2d 248, 252 (1988) (according only findings made in criminal cases collateral estoppel effect in attorney disciplinary proceedings).

Steadman v. SEC, 450 U.S. 91, 102, 101 S.Ct. 999, 1008 (1981) upheld a bar prohibiting association with a broker-dealer that had been made pursuant to a preponderance of evidence standard. However, that holding should not be extended to proceedings that impair the value of a *professional* license, as opposed to a business license, given the greater investment in time and education needed to obtain a professional license and the larger reputational interest embodied in a business license. *See, e.g.*, *Nguyen v. State*, 29 P.3d 689, 697 (Wash. 2001) ("[Revocation of a medical license involves] much more than the loss of a specific job. It involves the professional's substantial interest to practice within his profession, his reputation, his livelihood, and his financial and emotional future. [That is why] the constitutional minimum standard of proof in a professional disciplinary proceeding for a medical doctor must be something more than a mere preponderance [of the evidence]."); *see also: U.S. v. Shotts*, 145 F.3d 1289, 1296 n.9 (11th Cir. 1999) (right to practice law and medicine are protected property interests, while bail bond licenses are not); *In re Isaacson*, 478 B.R. 763, 778 (Bankr., E.D. Va. 2012) (" . . . [T]he Business License cannot be conflated with a professional license, which implies by its issuance a certain level of competence to perform duties in a regulated profession, such as law, medicine, architecture, engineering or general contracting.")

Point II

The Obey-the-Law Injunction Entered By the District Court Is Invalid and Does Not Justify Continuing the Temporary Suspension

As noted, the District Court entered an obey the law injunction. However, it contained no

guidance as to what particular conduct is prohibited. *Id.*, 51, ¶41 ("Based on the evidentiary record, and an analysis of the relevant factors, it is reasonably likely that Randall will engage in future violations of the law and should be permanently enjoined."); ¶43 ("Accordingly, Randall should be enjoined permanently from violating the provisions of the Advisers Act which are at issue in this case.") The injunctive relief ordered by the District Court is defective because it fails to track the statutory language and fails to inform Goulding of what conduct is prohibited. *E.g.*, *SEC v. Goble*, 682 F.3d 934, 951-952 (11th Cir. 2019). Accordingly, it cannot justify the continuance of the temporary suspension prior to a hearing.

Point III

The District Court Overlooked that Fact that Goulding Was Indisputably Entitled to Receive $869,749.99 that the SEC's Case at Trial Did Not Credit Him For

Since the District Court's findings under the preponderance of evidence standard cannot be accorded preclusive effect, Goulding can only be disbarred or sanctioned based on a *de novo* review of his conduct.

The District Court's finding that Goulding misappropriated $642,422 was based Trial Exhibit PX43, a summary prepared by SEC accountant Ann Tushaus, and admitted pursuant to Federal Rule of Evidence 1006. Judge Gilbert determined that PX43 established that Goulding received $642,422 more in transfers and benefits from The Nutmeg Group, LLC than he made in transfers to Nutmeg during the relevant period. Findings and Conclusions, p. 36 at 276.

Judge Gilbert's Findings and Conclusions distinguish between two types of compensation Nutmeg received, *i.e.*, "administrative fees" and "performance fees." SEC v. Nutmeg Dkt., ECF 1085, p. 8, ¶64. ("Nutmeg received administrative fees and performance fees

from the Funds."); pp. 8-9, ¶65 ("The fee structure varied by fund. Nutmeg received a one-time four percent (4%) administrative fee, which was deducted from an investor's original investment, in Adzone, Tropical, Startech, Image Globe, Nanobac, MiniFund, MiniFund II, Lightning, October, Michael, Fortuna, and Patriot."); p. 9, ¶66 ("These same Funds also paid Nutmeg a performance fee, which ranged from 15% to 20% of the Funds' profits.")

The "administrative fees" discussed in the Findings and Conclusions were non-contingent management fees: that is, they were not based on performance or valuation. Goulding's December 10, 2019 memorandum of law (SEC v. Nutmeg Dkt., ECF No. 1097), at pp. 6-7. According to Crowe Horwath, the accountant retained on behalf of the SEC, and the SEC's own exhibits, Nutmeg's contractual right to administrative (or non-contingent management fees) included the following entitlements:

$169,636.24 in 2004 based on $4,086,242.66 in capital contributions received in 2004 (PX61/ECF No. 1031-1, at p. 18.)
$152,182.28 in non-contingent management fees (*id.* at p. 24) based on a total of 4,608,035.93 in capital (PX61/ECF No. 1031-1, p.)
$**246,321** in management fees based on the 2007 Mercury Offering. PX59 at p. 12 (4 percent fee based on a total of $6,158,031 (PX59, at p. 12); PX63 at p. 24

Total

The $568,139.78 total was not the extent of Nutmeg's contractual entitlement to management fees, because there were additional offerings. SEC proposed Trial Exhibit PX68, yet another Crowe summary, shows that in total, from 2003 through 2009, the various Funds for which Nutmeg acted as general partner and Investment Advisor received a total **$869,749.99** in management fees based on $23,726,695.23 in capital contributions received. *Id.* at p. 7.

The **$568,139.78** in entitlements shown above does not include all offerings. Also, the **$869,749.99** in total entitlements is based on a period – *i.e.*, between 2003 and March 23, 2004 –

that slightly predates the applicable five year limitations period that the Court applied in interpreting PX43. However, those amounts represent the respective low and high ends of the amounts of administrative (or non-contingent) fees that Nutmeg was entitled to receive and pass through to Goulding.

However, PX43 does not purport to consider Nutmeg's right to compensation from the various investor pools (e.g., Mercury Fund, Fortuna Fund, Michael Fund, etc.) for which it acted as general partner and Investment Advisor. As SEC accountant Ann Tushaus, CPA, who prepared PX43, testified:

> Q . . . [On] PX43, you see that you show a total benefit of $2.5 million and change to Randall Goulding; isn't that correct?
> A. Yes.
> Q. *Okay. Now, did you ever yourself conduct any analysis of what [Nutmeg] was entitled to receive under its agreements with the various investment funds?*
> *A. No.*
> *Q. Okay. So you yourself -- you don't have any view one way or another as to whether the amount that Nutmeg was entitled to receive under its agreements with the investment funds was more or less than $2.5 million?*
> *A. I do not have an opinion.*

Trial Transcript, p. 1144:19-1145:9 (emphasis added).

Accordingly, upon a hearing *de novo,* no misappropriation can be shown. *In re Dixon*, 535 B.R. 450 (Bankr., N.D. Ga. 2015), a non-dischargeability case under Chapter 7 of the U.S., Bankruptcy Code, summarized the nature of a disgorgement order that had been imposed against the debtor in a prior SEC enforcement proceeding (*SEC v. Onyx Capital*, 2014 WL 354491 (E.D. Mich., Jan. 31, 2014)) as awarding only the difference between the compensation the debtor had received and that he had been entitled to receive:

> OCA, therefore, retained $3,101,239 while only being entitled to management fees of $1,291,667. This differential is $1,809,572, which is the

basis for the District Court's finding that the Debtor and OCA misappropriated approximately $1.8 million in excess management fees.

In re Dixon, *supra,* 535 B.R. at 459-460 (emphasis added).

The ruling in *SEC v. Onyx* that the *Dixon* decision discusses thus confirms that misappropriation only occurs if the defendant receives compensation in excess of its contractual entitlements. *See also: S.E.C. v. Antar*, 120 F. Supp. 2d 431, 437-438 (D.N.J. 2000), *aff'd* 44 Fed.Appx. 548 (3d Cir. 2002) ("[W]hen determining the appropriate amount of disgorgement" the court must distinguish between "illegal profits gained and ... legal profits, . . [.]"); *SEC v. Bilzerian*, 814 F.Supp. 116, 121 (D.D.C.1993) (in determining the appropriate amount of disgorgement, it is important to distinguish between "benefits from lawful conduct and benefits from unlawful conduct."); *accord: Griffith v. Barnes*, 560 F.Supp.2d 29 (2008) (". . . [T]he court must distinguish between illegally and legally obtained profits." citing *S.E.C. v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1231 (D.C. Cir.1989)).

Point IV

Upon a Hearing *De Novo*, Goulding Will Show that There is No Basis for a Finding that He Improperly Received Non-Contingent Mananagement Fees

Also, the SEC can only obtain disgorgement of amounts "causally connected to the violation." *SEC v. Ferrone*, 188 F.Supp.3d 709, 714, 726 (N.D. Ill. 2015) ("[T]he record does not support a finding that McClain Jr.'s receipt of $335,000 from Argyll Equities between April 23, 2007 and January 1, 2009 represented the ill-gotten gains from his insider trading of Immunosyn stock.") *Accord: SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir.1989) ("Since disgorgement primarily serves to prevent unjust enrichment, the court may exercise its equitable power only over property causally related to the wrongdoing." (emphasis added,

internal citations omitted)); *SEC. v. Patel*, 61 F.3d 137, 139 (2d Cir.1995) ("The amount of disgorgement ordered need only be a reasonable approximation of profits causally connected to the violation." (emphasis added, internal citations omitted)).

Here, the non-contingent management fees that Nutmeg obtained based on a percentage of total capital contributions (and that Goulding was entitled to receive through Nutmeg) is not causally related to any misconduct. In fact, none of the District Court's Findings or Conclusions establish that Goulding Nutmeg committed any fraud in the securities offerings in which these capital contributions were solicited and received.

"To meet the 'in connection with' requirement, the fraud practiced must have been prior to or contemporaneous with the sale of securities." *First Fed. Sav. & Loan v. Oppenheim, Appel, Dixon*, 629 F. Supp. 427, 439 (S.D.N.Y. 1986) (citation omitted); *Freschi v. Grand Coal Venture*, 551 F.Supp. 1220, 1230 (S.D.N.Y. 1982) ("For Section 10(b) purposes the only investment decision made by Freschi occurred on December 29, 1977. Hence, defendants are correct in their assertion that Freschi can only recover for conduct committed before that date; subsequent conduct would lack the requisite 'in connection with the sale or purchase of any security.'")

The non-contingent management fees the Goulding received were based solely on the sale and offering of securities, which was *not* found by the District Court to be fraudulent. Instead, the misconduct found by the District Court relates to record-keeping violations, financial reporting, the use of *alter egos* as investment vehicles, and the valuation of the assets that the Funds purchased with the capital contributions. In other words, all the adjudicated misconduct relates to the manner in which the capital contributions paid into the Funds were used,

maintained, managed and/or invested, and none of it relates to the offerings in which Nutmeg solicited those capital contributions (and obtained the $869,749.99 in non-contingent management fees). *SEC v. Pattison*, 2011 WL 723600, *4 (N.D. Cal., Feb. 23, 2011) (rejecting the disgorgement amount requested by the SEC because "The entirety of the profit made on the options is not causally connected to the backdating practice herein."); *S.E.C. v. Resnick*, 604 F.Supp.2d 773, 783 (E.D.N.Y. 2009) (". . . [I]t is reasonable to assume that Mr. Kaiser performed various functions of value to the company other than the fraudulent activities which inflated earnings. Accordingly, I cannot conclude, based purely on Mr. Lee's testimony, that Mr. Kaiser's salary was causally linked to his unlawful conduct, and will not order disgorgement.")

Point V

Upon a Hearing *De Novo*, Goulding Will Show that There Was No Over-Valuation of the Funds Assets

The overvaluation claim at issue in *SEC v. Nutmeg* related to convertible debentures held by two funds Nutmeg controlled and/or advised: Mercury Fund and Stealth Fund. Nutmeg's method of valuating these securities, reduced to its essence, was to calculate the number of shares of common stock that the debentures could be converted into as of the valuation date, and multiply that number by the published market prices of otherwise identical unrestricted shares, and make appropriate (downward) adjustments to account for economic considerations. Trial Transcript, at 1337:11-18.) At all relevant times, and to this day, Goulding (and his counsel) believe that Nutmeg's method was not only proper but mandatory under the guidance provided by the Federal Accounting Standard's Board ("FASB"). In particular, Goulding attempted (and as he and his attorneys believe, succeeded) in valuing these securities according to Financial

Accounting Standard 157, re-promulgated as Accounting Standard Codification 820 (hereinafter "FAS 157/ASC 820"). The SEC's regulatory divisions (as distinct from its Division of Enforcement) require application of FAS 157/ASC 820.

(a) The SEC Cannot Show That Goulding Overvalued The Funds By A Particular Amount

The SEC's claim at trial was that Nutmeg had used an incorrect methodology, not that valuations were mis-stated by any particular amount. At trial, SEC expert evaluation witness Peter Hickey testified that he focused on valuation "methodologies," and "ha[d] not formed an opinion as to what correct valuation numbers would be" and that his opinion "didn't put an actual number on it." Trial Transcript, at 695:8-11.

The SEC's inability to quantify the alleged overvaluation means that it cannot prove the claim. In *SEC v. Mannion*, 2013 WL 1291621, *12, *14 (N.D. Ga., Mar. 25, 2013) the SEC contended that hedge fund assets, including convertible debentures, had been overvalued, but did not demonstrate "the amount" of the overvaluation. The defendant obtained summary judgment dismissing the overvaluation claims because, as the Court stated, "[a]bsent evidence of the extent of these over-valuations," the "trier of fact cannot conclude that the over-valuations . . . were material[.]" *See also: Fulton Cty. Emps. Ret. Sys. v. MGIC Inv.*, 2010 WL 5095294, *7 (E.D. Wis. 2010), *aff'd* 675 F.3d 1047 (7th Cir. 2012) ("[T]he relevant question is not whether C-BASS's assets declined in value, but by how much. That three inputs into C-BASS's fair-value determination pointed downward does not tell me anything about the magnitude of the write-offs C-BASS should have taken."); *see generally:* Salvatore Massa, "Outside a Black Box: Court and Regulatory Review of Investment Valuations of Hard-to-Value Securities, 8 *Wm. & Mary Bus. L. Rev.* 1, 43-44 (2016) (where "applicable accounting guidance provides wide

latitude," the plaintiff must show not only variance from how the asset should be valued but also "the dollar impact of the variance").

(b) Goulding Cannot Be Disciplined Based on Valuation Methodology that He Used, Since that Methodology Was Consistent With FASB Guidance

(1) The SEC's Position at Trial: The Convertible Debentures at Issue Should Be Valued According to the Value of their Debt Component

At trial, Hickey, the SEC's valuation expert, opined that Nutmeg should not have valued convertible debentures according to the market value of the underlying common stock; that it would be improper to value restricted securities based on the market value of otherwise identical unrestricted stock; and that blockage and illiquidity discounts should be applied. That was a pre-FAS 157/ASC 820 approach based on the SEC's Accounting Series Release ("ASR") 113.

However, the FASB guidance - FAS 157/ASC 820 - superseded ASR 113. (FAS 157, at the Summary Statement.) FAS 157 represented a "shift from rules-based to principles-based hierarchical guidance." It is well recognized that the distinct approaches mandated under ASR 113 and FAS 157/ASC 820 cannot be reconciled. *See, e.g.*, Janet K. Smith, Ph.D, et al., "The SEC's 'Fair Value' Standard for Mutual Fund Investment in Restricted Shares and Other Illiquid Securities," 6 Fordham Journal of Corporate & Financial Law 421, 422, 443-444 (2001) (criticizing ASR 113 based on subjective criteria, rather than prices in the underlying security, for presuming that restricted securities should be valued essentially based on what could be obtained if liquidated in a current sale and deference to the judgment of the reporting entity's board of directors, so long as certain procedural requirements (such as board minutes are met)). A list of the distinctions and contrasts between the ASR 113 approach and that mandated under

FAS 157/ASC 820 is attached as an Appendix to this petition.

The SEC's case at trial repeatedly asserted that Nutmeg had not adhered to ASR 113 (the prior standard). In fact, SEC's valuation witness, Peter Hickey referred to ASR 113 nine times in his direct testimony. Trial Transcript, at 602-603, 606, 607, 609, 612, 622, 682.)

Applying ASR 113, Hickey concluded that a portion of the debentures at issue could not be immediately converted into unrestricted stock. Under ASR 113, those securities should be valued based on a hypothesized "current sale" which is understood to be a distress price. ASR 113 is "fundamentally a liquidation value principle." Smith, "The SEC's 'Fair Value' Standard," supra, 6 Fordham J.C.&F.L at 423. In determining what could be obtained in a "current sale," ASR 113 states that adjustments from the market price of the otherwise identical unrestricted security are an inherently unreliable measure, a view based on a presumption that the market might overreact to news regarding the purchase of restricted securities, "thus lead[ing] to a spiraling increase in the valuation of both the restricted and unrestricted securities." ASR 113, at p. 4. ASR 113 thus distrusts the market's interpretation of the restriction. ASR 113, p. 4. In total, these consideration mandated excluding from the analysis what could be obtained upon conversion of the securities.

Relying on ASR113, the SEC's valuation witness, Hickey, declined to consider the value of the securities into which the convertible debentures could be converted. E.g., Ex. 5, Tr: 731:21 - 732:8. (". . . [T]here is restricted stock [sic: convertible debentures] that the Mercury Fund owned that I have talked about at length, and then there's common stock that was being traded for these companies as well, and that's not what Mercury Fund owned.") This means that Hickey, the SEC's expert, valued the convertible debentures according to their debt component -

i.e., excluding the value of the feature that permitted them to be converted into common stock which could be sold at prevailing market prices.

(2) Goulding's Position at Trial: The Convertible Debentures at Issue Should Be Valued According to the Value of their Equity Component

By contrast, Goulding and Nutmeg valued the convertible debts based largely on the prevailing market value of the common stock into which they could be converted. This is the approach that is mandatory under FASB Guidance that is currently in place, and was also in place at the time of the valuations that the SEC challenged. This is the impact of FAS 157/ASC 820 which requires that, where there is an active market for a security related to (or underlying) one for which there is no such market, the value of the latter should reflect that of the former.

First, as previously noted, the securities at issue were "floating convertibles," since they could be could be converted to stock at specified discounts from prevailing market prices. Therefore, a change in the market price of the stock does not change the intrinsic value of the conversion feature. *Securities & Exchange Commission v. Parnes*, *supra*.

Under FASB guidance, floating convertibles are classified as "stock settled debt." According to that guidance, the relative value of the debt and conversion features of stock settled debt must be considered. "Relative fair value" means: "Estimating the fair value of each individual component of the hybrid instrument and allocating the basis of the hybrid instrument to the host instrument and the embedded derivative based on the proportion of the fair value of each individual component to the overall fair value of the hybrid." FASB Statement 133 Implementation Issue No. B6.

While an issuer of a convertible debenture may, in certain instances, have the option of

repaying the amount borrowed directly (rather than issuing stock to the investor according to the conversion formula), such cash payments are usually not a realistic option because only companies with poor balance sheets will issue floating convertible debentures, since they shift risk to the issuer. In fact, the notes acquired by the Funds managed by Nutmeg gave the investor – that is, the Funds – the option to insist on receiving stock (pursuant to the conversion feature), rather than cash. Accordingly, the conversion feature – the right to convert the instrument to stock which could be sold at prevailing prices – represented the entire value of these debentures at issue in the *SEC v. Nutmeg* case. As Goulding (properly) understood it, this meant that both issuers of such securities and investors in them were required to value them "us[ing] [an] effective conversion price to measure the intrinsic value, if any, of the embedded conversion option[.]" ASC 470-20-30-5(c) (applicable to issuers); ASC 820-10-05-1B & 1D (assets and liabilities are valued in the same way, which means that investors must value their assets the same way issuers value their liabilities).

What the applicable FASB guidance means – stated in normal English rather than the vocabulary that FASB uses – is as follows: For floating convertibles, the contractual discount from prevailing stock prices means that the conversion feature (the right to convert to common stock and sell it) is always "in the money," *i.e.*, the market price for the common stock always exceeds the conversion price. Portfolio Advisory Group, *Convertible Debentures - A Primer 2* (May 12, 2011) (when security is trading above the conversion price it is "commonly referred to as 'in the money'"); cf. ASC 470-20, Master Glossary, defining a "Beneficial Conversion Feature" as a "a nondetachable conversion feature that is in the money at the commitment date."). This favors valuing the instrument based on the value of the underlying securities.

Convertible Debentures, *supra* ("When a convertible is trading deep in-the-money, it will take on the characteristics of the underlying equity as opposed to a debt obligation."); *see generally:* Small Business Administration, *Appendix 15: Valuation Guidelines for Small Business Investment Companies* 148 (Aug. 3, 1999) ("Accepted methods for valuing convertible debentures" include "consider[ing] the conversion of all convertible securities of the same class into their common stock equivalent, taking into account dilution, and a subsequent valuation of the [owner's] proportionate equity interest.") That is precisely what Nutmeg and Goulding did.

(3) Goulding's Valuation Approach Was Mandated Since the SEC Requires Compliance with FASB Guidance

Goulding was adhering to the applicable FASB guidance, and obviously can't disciplined for following guidance that the SEC has itself stated is mandatory. *See* SEC, "Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter," Release Nos. 33-8221; 34-47743; IC-26028; FR-70.

(4) Even if Goulding's View Was Incorrect He Should Not Be Disciplined for A Good Faith Error Regarding a Matter of Opinion

Goulding's view that the convertible debentures should be valued primarily according to conversion feature, rather than their debt feature, even if wrong, was at minimum a colorably correct matter of opinion and therefore is not an appropriate basis for disciplinary action. NY Eth. Op. 635, 1992 WL 348747 (N.Y. St. Bar. Assn. Comm. Prof. Eth., Sept. 23, 1992) (" . . . [J]ust as matters of opinion, judgment or strategy upon which competent lawyers could disagree do not necessarily give rise to civil liability for malpractice, such matters would not ordinarily form the basis for attorney discipline, and thus do not involve the kind of conduct the reporting of which is required under DR 1-103(A).")

In *In re Carter*, [1981 Transfer Binder] Fed.Sec.L.Rep. (CCH) 82,847, at 84,167 (SEC App., Feb. 28, 1991), an administrative appeal, the SEC held that lawyers who prepared incorrect proxy materials and disclosures that misled investors could not be sanctioned under SEC Rule 102(e) for errors in judgment. The SEC reasoned that if a securities lawyer is to exercise his "best independent judgment . . . [,] he must have the freedom to make innocent – or even, in certain cases, careless – mistakes without fear of [losing] the ability to practice before the Commission. *See generally:* ABA Comm. on Professional Ethics, Informal Opinions, No. 1273 (1973) ("error of judgment made in good faith" does not justify a finding that the attorney violated professional diligence or competence requirements).

Point VII

Upon Hearing *De Novo*, Goulding Will Establish that There Were No Improper Transfers to Affiiated Entities

The District Court's findings that Goulding improperly transferred Fund assets to Nugmet's affiliates is wrong. Upon a hearing *de novo*, Goulding will show that this was, instead, the a proper use of special purpose vehicles.

In fact, what happened was perfectly legal. Goulding arranged for certain Funds to make investments through certain affiliates, or for assets to be titled in the name of such affiliates, for the benefit of the Funds. It was Goulding's intention that these affiliates function as special purpose vehicles, since such "SPVs" are legal devices, and since assets "titled" in the name of SPVs are properly attributable to the investment pools, neither the attempt to use such SPVs nor the dissemination of the account statements attributing the assets they held to the investment pools was either an intentional or reckless violation of any law or rule.

The SEC has commented on SPVs in the following fashion:

> Investment advisers to pooled investment vehicles may from time to time use special purpose vehicles (SPVS) to facilitate investments in certain securities by one or more pooled investment vehicles that the advisers manage. These SPVS are typically established or controlled by the investment adviser or its related persons who often serve as general partners of limited partnerships (or managing members of limited liability companies, or persons who hold comparable positions for another type of pooled investment vehicle).

SEC Release No. Release No. IA-2968, File No. S7-09-09, 6p. 41 (December 30, 2009).

This release specifically provides that: "To comply with the [custody] rule, as amended, the investment adviser could either treat the SPV as a separate client, in which case the adviser will have custody of the SPV's assets, or treat the SPV's assets as assets of the pooled investment vehicles of which it has custody indirectly." *Id.* It was entirely proper – indeed, it was required – that the account statements show the assets held by the investor special purpose vehicles (i.e., Nutmeg's affiliates) as belonging to the respective Funds. *Id. See also:* SEC, Guidance Update No. 2014-07 7, pp. 2-3, at Scenarios 1 & 3 (where the pooled investment vehicle invests a portion of its capital in either single purpose or multi-purpose special purpose vehicle, which in turn invests in either one or more investments, and the special purpose vehicle has no owners other than the adviser's related person(s), the adviser may choose to treat the assets of the single purpose vehicle as assets of the pooled investment vehicle client).

Since it was Goulding's intention that the relief defendants function as such special purpose vehicles, since such "SPVs" are legal devices, since assets "titled" in the name of SPVs are properly attributable to the investment pools, neither the attempt to use such SPVs nor dissemination of the account statements attributing the assets they held to the investment pools was either an intentional or reckless violation of any law or rule.

G. CONCLUSION

For the foregoing reasons, the petition should be granted in its entirety.

Dated: New York, New York
March 20, 2020

Berry Law PLLC

By: /s/ Eric W. Berry
Eric W. Berry
Attorneys for respondent
Randall S. Goulding
745 Fifth Avenue, 5th Floor
New York, New York 10151
212-355-0777 (ph)
212-750-1371 (fax)
email berrylawpllc@gmail.com

To: Donna S. McCaffrey, Esq.
Attorney for plaintiff Securities
and Exchange Commission
100 F. Street, N.E.
Washington, D.C. 20549
(202) 551-2000
mccaffreyd@sec.gov

CERTIFICATE OF SERVICE

Eric W. Berry, pursuant to 28 U.S.C. §1746 hereby certifies that the following statement is true and correct:

On March 20, 2020, I caused the annexed Answer to be served by email upon:

Donna S. McCaffrey, Esq.
Attorney for plaintiff Securities and Exchange Commission
100 F. Street, N.E.
Washington, D.C. 20549
(202) 551-2000
mccaffreyd@sec.gov

by email.

Dated: New York, New York
March 20, 2020

/s/ Eric W. Berry
Eric W. Berry

APPENDIX

Differences Between Standard that Applied in 2008 (FAS 157/ASC 820) and That Which Applied Under Prior Standard (ASR 113)

(a) ASR 113 is considered a "certification" approach that requires the directors of the reporting entity to certify that its valuations of restricted securities were in good faith (*id.* at p. 4), even if based on information which may be known only to that them Janet K. Smith, Ph.D, *et al.*, "The SEC's 'Fair Value' Standard for Mutual Fund Investment in Restricted Shares and Other Illiquid Securities," 6 *Fordham Journal of Corporate & Financial Law* 421, 444 (2001) ("A . . . problem with certification" standards under ASR 113 and 118 is that they "provide a roadmap to boards that wish to distort their reported NAVs. * * * As long as a board maintains records of its deliberations and does not value its restricted share holdings too highly, its conclusions about value are difficult for the SEC to challenge.") **By contrast**, FAS 157/ASC 820 discourages uses of such "invisible" information, which it designates as "Level 3 inputs," and favors the transparency of market prices, either for the security itself (Level 1 inputs) or similar securities (Level 2 inputs).

(b) ASR 113 deems all "restricted" stock as securities for which "market quotations are not readily available." ASR 113, p. 2. **By contrast**, under FAS 157, for securities that are traded in active markets, stock that has restrictions expiring within one year, are considered to have "readily ascertainable prices." FAS 157-69.

(c) Under ASR 113, the directors of the reporting entity are required to value these securities "upon their current sale." *Id.*, p. 4. The "current sale" standard under ASR 113 is "fundamentally a liquidation value principle." Smith, "The SEC's 'Fair Value' Standard," *supra*, 6 *Fordham J.C.&F.L* at 423. The secondary market of private sales of restricted securities is extremely limited consisting essentially of sales pursuant to the "4(1-1/2) exemption."[1] These circumstances, together with the fact that private sales of restricted shares "often face financial distress," means that the prices obtained in such transactions "are negatively biased measures. . . ." *Id.*, *supra*, 6 *Fordham J.C.&F.L* at 442. In determining what could be obtained in a "current sale," ASR 113 asserts that adjustments from the market price of the otherwise identical unrestricted security are an inherently unreliable measure, which is based on a presumption that the market might overreact to news regarding the purchase of restricted securities, "thus lead[ing] to a spiraling increase in the valuation of both the restricted and unrestricted securities." ASR 113, at p. 4. ASR 113 thus *distrusts* the market's interpretation of the restriction. ASR 113, p. 4. **In diametric opposition,** FAS 157/ASC 820 *requires* that restricted securities maturing within one year must be valued based on adjusted active market prices for the

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[1]This is the common law exemption for private resales of restricted securities in circumstances similar to those typically associated with private sales by the issuer. *See* Carl H. Schneider, "Section 4(1-1/2)-Private Resales of Restricted or Control Securities," 49 *Ohio State Law Journal* 501, 504 (1988)

otherwise identical unrestricted securities, *to the extent that "market participants" would make such adjustments*. FAS 157-69, FAS 157-25 & n.19 and FAS 157-3 ("A fair value measurement for a restricted asset should consider the effect of the restriction if market participants would consider the effect of the restriction in pricing the asset.") FAS 157/ASC 820 *trusts* the market's valuing of the restriction.

(d) ASR 113 assumes that: "Significant holdings of restricted securities not only magnify the valuation difficulties but may also present serious liquidity questions." *Id.* at 7. **By contrast,** relevant contemporary FASB guidance permits the conversion option to be accounted for based on whether the shares received in the smallest available conversion "increment" could be converted to cash "without effecting the market price" (ASC 815-10-55-105), and regardless of whether the "whether the entire bond, if converted, could be sold without affecting the price." (ASC 815-10-55-106). *See also:* FAS 133 Implementation Issue No. A12, Response to Question 1 ("The investor need not determine whether the entire bond, if converted, could be sold without affecting the price. Because the $100 million convertible bond is convertible in increments of $1,000, the convertible bond is essentially embedded with 100,000 equity conversion options, each with a notional amount of 100 shares.")