UNITED STATES OF AMERICA Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of DONALD J. FOWLER, Respondent.	ADMINISTRATIVE PROCEEDING File No. 3-19740

DONALD FOWLER'S SUPPLEMENT TO OPPOSITION TO
THE ENFORCEMENT DIVISION'S MOTION FOR SUMMARY DISPOSITION

As previously indicated, this will serve as the Supplement to Respondent Donald Fowler's Opposition to the Enforcement Division's Motion for Summary Disposition, filed on August 5, 2020. Annexed hereto is the Second Circuit Appellate Brief, which Mr. Fowler filed on August 6, 2020. As set forth therein, the District Court, *inter alia*: (1) lacked subject matter jurisdiction; (2) erred in allowing the SEC to avoid the pleading elements of churning by recharacterizing the claims as ones for "reasonable basis suitability"; (3) and erred in allowing the SEC to assert "unauthorized trades" for investors who never accused Appellant of such. In light of the foregoing, the Judgment upon which this proceeding is based is a nullity.

Dated: New York, New York
August 7, 2020

EMMET, MARVIN & MARTIN, LLP

By:______________________________

John Dellaportas
Beth Khinchuk
120 Broadway
New York, NY 10271
Tel 212.238.3000
Attorneys for Respondent
Donald J. Fowler

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that, per 17 C.F.R § 201.150, the notice of the foregoing has been emailed to David Stoelting at StoeltingD@sec.gov on this 7th day of August, 2020. Additionally, an electronic copy was submitted to apfilings@sec.gov.

/s/ *Beth Khinchuk*

Beth Khinchuk

20-1081-cv

17-cv-139(SDNY)

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

Securities and Exchange Commission,

Plaintiff-Appellee,

—against—

Donald J. Fowler,

Defendant-Appellant,

Gregory T. Dean,

Defendant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR DEFENDANT-APPELLANT
DONALD J. FOWLER

John Dellaportas
Beth Claire Khinchuk
EMMET, MARVIN & MARTIN, LLP
120 Broadway
New York, New York 10271
(212) 238-3100

Attorneys for Defendant-Appellant
Donald J. Fowler

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JURISDICTIONAL STATEMENT[1]

As set forth in Point II of the Argument below, Defendant-Appellant Donald J. Fowler ("Appellant") disputes that subject matter jurisdiction exists over this action. In its Amended Complaint (Dkt. 25), Plaintiff-Appellee Securities and Exchange Commission (the "SEC") asserted that it brought this action "pursuant to authority conferred by Section 20(b) of the Securities Act [15 U.S.C. § 77t(b)] and Section 21(d)(1) of the Exchange Act [15 U.S.C. § 78u(d)(1)]," and that the District Court had "jurisdiction over this action pursuant to 28 U.S.C. § 1331, Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)], and Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e), and 78aa]."

To the extent the District Court had jurisdiction, this Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 1291, because this appeal is from a final decision that disposes of all claims. On June 21, 2019, a jury verdict was rendered (the "Verdict"). SPA 64-66. On February 25, 2020, the District Court entered a Memorandum Opinion and Order (the "Penalties Order") granting injunctions, penalties and disgorgement. SPA 67-91. On February 28, 2020, the District Court entered a Final Judgment as to Appellant (the "Judgment"). SPA 92-95. On March 26, 2020, Appellant filed a timely Notice of Appeal. SPA 92-94.

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[1] This Court has approved the filing of a deferred appendix pursuant to Fed. R. App. 30(c) and Local Rule 30.1(c). Preliminary citations are to the Special Appendix ("SA"), District Court Case Docket ("Dkt."), Trial Transcript ("Tr."), and Trial Exhibits ("PX," "DX" or "JX").

STATEMENT OF ISSUES

1. Whether the District Court retained subject matter jurisdiction pursuant to 28 U.S.C. § 2462, where the SEC failed to commence this proceeding within five years from the date on which the claim first accrued, but instead relied upon tolling agreements purporting to extend that five-year period.

2. Whether the District Court erred, as a matter of law, in permitting the SEC to recharacterize its excessive trading/churning/quantitative suitability claim as a claim for "reasonable basis suitability" and thereby avoid its obligation to prove the element of *de facto* control of the account by Appellant.

3. Whether the District Court committed manifest injustice in permitting the SEC to assert claims against Appellant for unauthorized trading on customer accounts without eliciting testimony from those customers.

4. Whether the District Court erred, as a matter of law, in awarding the SEC civil monetary penalties against Appellant well in excess of those permitted by Congress under 15 U.S.C. § 77t(d)(2).

5. Whether the District Court's award of civil monetary penalties violated the Fifth and/or Eighth Amendments to the U.S. Constitution.

6. Whether the District Court's disgorgement award should be remanded, in light of the Supreme Court's decision in *Liu v. SEC,* 140 S. Ct. 1936 (2020), to recalculate with legitimate business expenses deducted.

STATEMENT OF THE CASE

A. Nature of the Case

This appeal is taken from the Judgment of the U.S. District Court, Hon. Gregory H. Woods (the "District Court"), in the civil enforcement proceeding brought by the SEC. While Appellant respectfully disagrees with the underlying Verdict, he does not seek, by this appeal, to revisit either the jury's weighing of the evidence or the District Court's conducting of the trial. Rather, Appellant seeks appellate review only of certain legal errors made by the District Court which led to that Verdict and subsequent Penalties Order.

As set forth in the Argument below, the District Court, via an *in limine* ruling, improperly permitted the SEC to recast its excessive trading/churning/quantitative suitability claim as a "reasonable basis suitability" claim and thereby avoid its obligation to prove that Appellant had *de facto* control of customer accounts. In another *in limine* ruling, the District Court improperly permitted the SEC to assert claims for unauthorized trading in customer accounts by Appellant without eliciting testimony from those customers on that issue. Following the Verdict, the District Court further erred by awarding civil monetary penalties of $1.95 million, an amount well in excess of the maximum set by Congress. The District Court also awarded disgorgement or $132,076 plus interest without deducting expenses, which the Supreme Court in *Liu, supra*, has now held to be improper.

Before addressing the foregoing issues, however, this Court should first determine whether the District Court had subject matter jurisdiction at all. Both of the SEC's causes of action accrued in 2011, but the SEC did not bring suit until 2017. Under 28 U.S.C. § 2462, the SEC was required to commence this case within five years from the date when its claims first accrued. Instead, the SEC relied on tolling agreements purporting to extend that deadline. As this is an issue of first impression, this Court will have to determine whether the SEC can use tolling agreements to circumvent this jurisdictional bar. For the reasons below, Appellant submits that the SEC has no statutory authority to do so.

B. <u>Relevant Facts</u>

Appellant is a resident of Massapequa, New York. Appellant attended Hofstra University and SUNY Farmingdale from 2004 to 2008, majoring in Business Administration, but left without graduating [redacted] Appellant thereafter decided to become a stockbroker. He passed the Series 7 and 63 examinations in 2005, and the Series 24 examination in 2008, and has worked steadily as a stockbroker since 2005. JX-6 ¶3-6. Appellant was employed as a registered representative at J.D. Nicholas & Associates, Inc. and its predecessor firm (collectively, "J.D. Nicholas") from January 2007 to November 2014. *Id.* at ¶4.

For investors wanting to invest broadly in the market, mutual fund companies like Fidelity and Vanguard provide a wide array of no-fee funds that match market indices and industry sectors. Some investors, however, hire stockbrokers to try to outperform markets. The broker typically conducts research, implements an investment strategy for the client, and is compensated by commissions. If the broker is successful, the gains will be sufficient for the investor to make a profit even after commissions. But with all investments, there is a risk of loss.

In his tenure at J.D. Nicholas, Appellant followed this standard model. For his stock recommendations, investors paid: (a) a per-trade fee of $49.95 to $65.00 (of which Appellant retained $2.50), and (b) a discretionary commission of 0 to 3.5% per transaction (of which Appellant retained 40%). These fees and commissions were Appellant's sole income for his services. *Id.* at ¶49.

While at J.D. Nicholas, Appellant worked with at least 497 different clients.[2] Appellant adopted different investment strategies for his clients depending on their wants and needs. Tr. 728-729. The SEC, in this case, has only taken issue with the trading strategy Appellant employed for thirteen of these clients (2.6% of the total), each of which lost money investing through Appellant. At trial, the SEC did not introduce any evidence as to the average investment performance of Appellant's 484 other clients, nor seek to compare that to the thirteen at issue here.

[2] Appellant testified at trial that he recalled having approximately 400 clients during his time at J.D. Nicholas. Tr. 811. However, trading records, which the SEC introduced into evidence at trial, showed that Appellant actually had 497 clients while at the firm. PX-238.

For the thirteen investors at issue in this case (collectively, the "Investors"), Appellant employed an opportunistic, event-driven trading strategy, which aims to outperform the market. *Id.* at 620. As he explained, "instead of being anticipatory, it is reactive strategy. You are reacting to an event … if you believe that the market has not fully digested … the significance of the event." *Id.* at 1167. "You are betting that your opinion is correct, good enough to expect to make money with a reasonable prospect of being able to get in and … get out when whatever you expect will ensue in the price of stock as a result of that news plays out that way and then you can close out your position and look for a profit." *Id.* at 1168.

To identify such profit opportunities, Appellant "would read different financial websites, research reports, different publications, 10-Q filings, … Wall Street Journal [and] Investor's Business Daily …." *Id.* at 847. Once he had an idea, Appellant "would then typically look at the financials on a company. How big the company was, … the amount of shares that are actually out on the market trading. I'd look at insiders' buys and sales to see sentiment from an insider's standpoint. I would look at recent news, I would look at recent upgrades and downgrades by other research analysts that had coverage on the company. I would then essentially look at the chart and the history of the chart. … And then at that point in time, if it passed … then I would make a recommendation." *Id.* at 848

The thirteen Investors are all relatively well-off. According to their respective

Investment Account Applications, ten of thirteen Investors are millionaires, one having a net worth of $20 million; the least well-off one has a net worth of $400,000. DX-412. As one of the Investors testified, "as far as I was concerned, [the money invested with Appellant] was sort of play money." Tr. 504.

In all thirteen Applications, the Investor described his Investment Objective as "Speculation," with "Speculative" Risk Exposure, and represented himself as having "Excellent" Investment Knowledge. JX-6 ¶27. Each Investor also signed a "Margin Account Agreement" containing cautionary disclosures as to the costs and risks of margin trading. *Id.* at ¶28. Ten Investors also signed an "Option Account Agreement" acknowledging receipt of a booklet entitled "Characteristics and Risks of Standardized Options." *Id.* at ¶29. Seven Investors also signed an "Intent to Maintain Active Account" document, providing as follows:

> **THE CLIENT AFFIRMS THAT THE MONEY USED IN HIS/HER ACCOUNT IS NOT THE CLIENT'S SOLE ASSET BASE, SOLE INVESTMENT ACCOUNT AND DOES NOT REPRESENT A MAJORITY OF HIS OR HER NET WORTH.** … You … are fully and completely aware of the risks involved with the trading strategy that you have adopted and that it may result in significantly greater gains or losses than alternative methods of investing and/or trading strategies. **Such strategies employed may involve an over concentration in one or more positions, a higher turnover of account equity, as well as a higher commission to equity ratio.**

Id. at ¶31; PX-257 (emphases in original). Yet the SEC went on to accuse Appellant of "fraud" for supposedly concealing these very same risk factors.

C. <u>Relevant Procedural History</u>

This case developed out of an investigation of J.D. Nicolas by the SEC that began in 2014. SPA 67. In March 2016, and again in August 2016, the SEC and Appellant entered into tolling agreements. *Id.* at 68. In January 2017, the SEC filed this action against Appellant and his business partner, Gregory Dean. *Id.* (The SEC settled with Mr. Dean on the morning of trial. *Id.* at 69.)

On April 21, 2017, the SEC filed its Amended Complaint, which remains the operative pleading in this case. Dkt. 25. In it, the SEC asserted two causes of action. *Id*. The First Claim for Relief alleged that Appellant violated Sections 17(a)(1), (2) and (3) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77q(a)(1), (2) and (3). The Second Claim for Relief alleged that Appellant violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5. *Id.*

According to the Amended Complaint, Appellant "recommended a trading strategy to [the Investors] without any reasonable basis to believe that the strategy was suitable for anyone." Dkt. 25 at 2. The strategy allegedly "was not complex: purchase a security, sell it about 9-days later, and charge the customer commissions and other fees." *Id.* However, Appellant supposedly knew or recklessly disregarded that his "high-cost strategy of excessive in-and-out trading … was bound to lose money and was not suitable for their customers." *Id.*

The Amended Complaint further alleged that "the same basic strategy" was used in the accounts of all thirteen Investors. *Id.* at 5. "This pattern of buys followed by sales repeated itself over and over in the customers' accounts." Consequently, Appellant allegedly earned "exorbitant commissions." *Id.* Meanwhile, "the impact of the costs that arose from [Appellant's] excessive trading [allegedly] doomed any possibility of even a minimal profit." *Id.* at 10.

This allegation of excessive trading for the purpose of generating commissions at customer expense is what is classically known as "churning." As discussed below, however, the SEC later asserted, in place of its churning claim, that the same excessive trading gave rise to a "reasonable basis suitability" claim. By renaming its churning claim in this manner, the SEC was able to obtain an *in limine* order precluding Appellant from introducing evidence as to customer sophistication, which is highly relevant to a claim for churning. SPA 1-63.

Meanwhile, the District Court also denied Appellant's *in limine* motion to preclude the SEC from introducing evidence related to non-testifying Investors. SPA 25. This was relevant because the SEC also alleged that Appellant had engaged in "unauthorized trades" in the accounts of all thirteen Investors, even though almost none of those Investors had ever alleged any such thing.

Prior to trial, Appellant sought to have the Verdict broken out by Investor, while the SEC argued that all Investors should be treated as "unitary":

> The Court has expressed concern as to the manner in which it may impose remedies following a theoretical finding of liability, particularly given differing evidence regarding unauthorized trading with respect to separate customers and the customer-specific suitability claims. The modified proposed verdict sheet requires the Jury to determine whether these claims have been proved, by a preponderance of the evidence, as to each customer.
>
> By contrast, the SEC respectfully proposes instructing the Jury as to the SEC's other theories of liability <u>by unitary questions in the special verdict form</u>. As the Court is aware, charges of schemes to defraud (Rules 10b-5(a) and (c), and Sections 17(a)(1) and (3)) are not properly broken out into a victim-by-victim special verdict form, given that reliance is not an element here and the scheme is characterized as a single scheme. *Cf. United States v. Stringer*, No. 10 Cr. 632 (GEL), 2012 WL 11269, at *13 (scheme charge "properly charged in a single count [in the verdict sheet] because 'those acts could characterized'—and in fact the government . . . did characterize them throughout the trial—'as part of a single continuing scheme.'" (citation omitted)). Nor, for similar reasons, is it proper to break out the "misrepresentations" charges (Rule 10b-5(b) and Section 17(a)(2)) customer-by-customer—indeed, the unlawfulness of an alleged misstatement is from the point of view of its maker and of a reasonable objective investor. See, e.g., *Lorenzo v. SEC*, 139 S. Ct. 1094, 1104 (2019).

Dkt. 164 (emphasis added).

The SEC mostly prevailed on the form of Verdict Sheet. Trial was then held on June 10-20, 2019. SPA 92. The SEC offered live testimony from only three Investors, with a videotaped deposition played of a fourth.[3]

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[3] According to the SEC, Investor Robert Weathers "live[d] in a very humble house about 20 miles outside of Waco, and he literally does not have any resources at all, and just was unable to travel, and I was disappointed. He wanted to be here. He wanted to give his testimony live. But it just was not possible." Tr. 86. The District Court did not ask the SEC why that agency, with an annual budget approaching $2 billion, lacked resources to provide Mr. Weathers with a coach ticket to New York. https://www.sec.gov/files/secfy19congbudgjust.pdf. More likely, the SEC wanted to avoid his appearance at trial, as he suffers from an illness that would present credibility issues with respect to any live testimony he might offer. Tr. 22.

Instead, the SEC presented its case mainly through two opinion witnesses: an SEC employee who sought to prove unauthorized trading with phone records (more on that below), and a paid witness who alleged unsuitability based on two statistical metrics: (a) "turnover ratio" (*i.e.*, the number of times per year a customer's securities are replaced by new securities); and (b) "cost-to-equity ratio" (the amount an account has to appreciate annually in order to cover commissions and other expenses). Tr. 128, 348. The SEC argued that a turnover ratio of six or more, and/or a cost-to-equity ratio in excess of 20%, indicated "excessive trading." Dkt. 25 at 11. All thirteen Investor accounts surpassed those ratios, and each of those Investors ended up losing money net of commissions. PX-1A.

The transaction histories, however, show that in almost every one of these Investor accounts, a single bad trade accounted for all or almost all of the losses on that account, even after commissions. For example, Louis A. Dellorfano lost $37,348 on his account; however, he lost $47,323 on a single bad trade (Zynga). Al Riedstra lost $18,517 on his account; however, he lost $38,298 on a single bad trade (LinkedIn). And Robert Weathers lost $24,307 on his account; however, he lost $28,472 on a single bad trade (Abercrombie & Fitch). PX-1E.

An inference one could draw from these numbers is that stock-picking is equal parts luck and skill, and the SEC—blessed with 20-20 hindsight—cherry-picked 13 accounts out of 497 accounts in which the Investor's luck turned sour.

Alas, that is not the inference the jury drew. Instead, the final Verdict Sheet (SPA 64-66, emphasis added) reads in relevant part as follows:

> l. Did the Defendant ***with scienter*** employ any device, scheme, or artifice to defraud, or engage in any act, practice, or course of business which operated or would operate as a fraud or deceit upon any person, in violation of Section 10(b) of the Securities Exchange Act (the "Exchange Act"), Exchange Act Rules 10b-5(a) or 10b-5(c), or Section 17(a)(1) of the Securities Act?
>
> Yes ✓ No
>
> 2. Did the Defendant ***with scienter*** make any untrue statement of a material fact, or any omission of a material fact, in violation of Section 10(b) of the Exchange Act and Exchange Act 10b-5(b)?
>
> Yes ✓ No
>
> 3. Did the Defendant: ***negligently*** obtain money or property by means of any untrue statement of a material fact, or by any omission of a material fact, in violation of Section 17(a)(2) of the Securities Act?
>
> Yes ✓ No
>
> 4. Did the Defendant ***negligently*** engage in any transaction, practice, or course of business which operated or would operate as a fraud or deceit: upon the purchaser of a security, in violation of Section 17(a)(3) of the Securities Act?
>
> Yes ✓ No
>
> 5. Did the Defendant ***with scienter*** recommend an investment strategy with no reasonable basis to believe the strategy was suitable for any customer, in violation of Section 10(6) of the Exchange Act?
>
> Yes ✓ No
>
> …

7. Did the Defendant ***with scienter*** make any unauthorized trade in the account of any of the following customers, in violation of Section 10(b) of the Exchange Act? Answer "Yes" or "No" as to each customer.

Kenneth J. Bayer:	Yes ✓	No
Lane Clizbe:	Yes ✓	No
Louis A. Dellorfano:	Yes ✓	No
G. Allen Deuschle:	Yes ✓	No
Steve B. Dimercurio:	Yes ✓	No
Jeffrey Funk:	Yes ✓	No
Bob Krueger:	Yes ✓	No
Clay B. Miller:	Yes	No ✓
Al Riedstra:	Yes ✓	No
Peter Skrna:	Yes ✓	No
Robert Weathers:	Yes ✓	No
Gary J. Wendorff:	Yes ✓	No
Donald Womeldorph:	Yes ✓	No

D. Rulings Presented for Review

As much as Appellant is disappointed by the Verdict, this appeal is addressed to the legal rulings of the District Court that came before and after it. Specifically, Appellant appeals from certain rulings in: (a) the District Court's May 22, 2019 bench order on the parties' respective *in limine* motions (the "*In Limine* Order"); and (b) the February 25, 2020 Penalties Order. SPA 1-63, 67-91.

In the *In Limine* Order, the District Court resolved various evidentiary issues. The ones most relevant to this appeal are: (a) its grant of the SEC's motion to preclude Appellant from introducing evidence of customer sophistication; and (b) its denial of Appellant's motion to preclude evidence about the accounts of Investors who would not be testifying at trial. *Id.* at 1-63.

As to "customer sophistication" evidence, the District Court ruled that:

> The SEC seeks to preclude defendants from introducing three categories of evidence …: (1) brokerage accounts that the customers held outside the defendants' firm; (2) other brokerage accounts that the customers had with the defendants' firm; and (3) the customers' tax returns.
>
> … Because defendants assert that the SEC advances a quantitative suitability claim masked as a reasonable basis suitability claim, they contend that the evidence of customer sophistication is highly relevant to the issue of control — which a plaintiff must demonstrate to state a claim that a party breached his quantitative suitability obligations. … Defendants' argument finds no support in FINRA guidance or the Circuit's precedent.
>
> … [T]he three categories of suitability claims are separate, and independent. There is no basis in the text of the rule to conclude that … any quantitative issue with a broker's proposed strategy must be pursued only as a quantitative suitability claim, rather than forming the basis for one of the other categories of claims.

Id. at 27-28. As to non-testifying Investor evidence, the District Court ruled that:

> Defendants next ask the Court to "preclude the SEC from offering evidence of unsuitability with respect to any customer that does not testify at trial." … Defendants argue that the Court should exclude this evidence because "[w]ithout that testimony, it will be impossible for the SEC to establish what material misrepresentations or omissions were made/omitted or which specific transactions were not suited to the customer's needs." … The Court declines to exclude the evidence … because "[g]enerally, on a motion *in limine*, the question of admissibility, not sufficiency, is the issue for the Court."

Id. at 24; *see also id.* at 19 (also denying Appellant's motion to exclude evidence of unauthorized trading in accounts not identified in Amended Complaint).

After the Verdict, the District Court was called on to issue an award of remedies to the SEC, both in terms of injunctions and in terms of penalties and disgorgement. This appeal focuses on the latter (although if liability is reversed, the injunctions should be as well). Specifically, the District Court ordered Appellant to disgorge $132,076 (plus interest), representing $104,568.40 in commissions and $27,498 in postage fees he received from the Investors. *Id.* at 81.

More significant here, the District Court also directed Appellant to pay civil penalties of $1,950,000. *Id.* at 90, 94. It first found that the scienter findings in the Verdict warranted Third Tier penalties—*i.e.*, fines of up to the greater of: (1) $150,000-$160,000 (depending on the date of the violation) for each violation committed by the defendant; and (2) such defendant's "gross amount of pecuniary gain." 15 U.S.C. §§ 77t(d)(2)(C), 78u(d)(3)(B) (iii), 80b–9(e)(2)(C); SPA 83. In this case, Appellant does not contest that, should liability on any of the scienter claims be upheld, <u>a single</u> Third Tier penalty would be permitted.

However, the District Court multiplied the $150,000 maximum penalty by 13, concluding that, because "the penalty provisions of the relevant securities laws do not define 'violation,'" it had discretion to deem each Investor a separate "violation." SPA 84. Thus, the District Court imposed a total penalty of $1.95 million—<u>fifteen times</u> the disgorgement amount, *i.e.*, the "gross amount of the pecuniary gain." For the reasons set forth below, that was in error.

SUMMARY OF ARGUMENT

Appellant respectfully submits six points for appellate review.

First, the District Court lacked subject matter jurisdiction under 28 U.S.C. § 2462 to entertain the case because the SEC alleged a fraudulent scheme accruing in 2011, and waited more than five years to bring suit. The SEC relied on tolling agreements purporting to extend this time limit, but it lacked Congressional authority to do so because § 2462 is jurisdictional and unwaivable.

Second, the District Court erred, as a matter of law, in permitting the SEC to recharacterize its excessive trading/churning/quantitative suitability claim against Appellant as one for "reasonable basis suitability" and thereby skirt its obligation to prove the element of *de facto* control by Appellant. The SEC publicly bragged about the "new theory" it invented for this case, but that theory improperly prevented the jury from learning that the thirteen Investors were mostly multi-millionaires with significant investing experience and an appetite for risk.

Third, the District Court committed manifest injustice in permitting the SEC to assert claims against Appellant for unauthorized trading in Investor accounts without eliciting testimony from most of those Investors on that issue. Instead, the SEC "proved" the claim through a bogus analysis of incomplete telephone records, which was debunked by the live testimony. Appellant was thus held liable for trades the customers themselves never claimed to be unauthorized.

Fourth, the District Court erred, as a matter of law, in ignoring the $150,000 statutory cap set by Congress in 15 U.S.C. § 77t(d)(2) and instead imposing $1.95 million in civil monetary penalties against Appellant. Although the District Court allowed the SEC to put its case to the jury as a "unitary" scheme, without differentiating among the thirteen Investors, it then assessed penalties based on the notion that each Investor should be treated as a separate "violation" under the statute. That is not at all how the federal courts have construed the statute.

Fifth, even if the District Court were otherwise permitted to ignore the statutory cap on civil monetary penalties, it was still constrained by the Fifth and/or Eighth Amendments to the U.S. Constitution, which prohibit penalties excessive as compared to the alleged harm. Here, the District Court calculated Appellant's gain from the alleged wrongdoing, in commissions and fees, to be $132,076, yet in addition to requiring Appellant to disgorge that amount (with interest), it imposed a further penalty of fifteen times that amount. The Supreme Court has previously held that a penalty of four times damages is close to the line.

Sixth, the District Court, in ordering disgorgement of $132,076, pointedly refused to reduce that sum by Appellant's business expenses. Subsequently, while this appeal was pending, the Supreme Court in *Liu v. SEC*, 140 S. Ct. 1936 (2020) held that legitimate expenses should be deducted. The Penalties Order should be reversed and remanded for a new disgorgement calculation.

ARGUMENT

I. Standard of Review

A District Court's factual findings are reviewed for clear error; its conclusions of law are reviewed *de novo. Charron v. Wiener*, 731 F.3d 241, 247 (2d Cir. 2013). A District Court's evidentiary rulings are reviewed for abuse of discretion. *Ret. Plan of UNITE HERE Nat. Ret. Fund v. Kombassan Holdings A.S.*, 629 F.3d 282, 287 (2d Cir. 2010). A District Court's choice of remedy is reviewed *de novo* if it is a matter of statutory interpretation (*Ehrenfeld v. Mahfouz*, 489 F.3d 542, 547 (2d Cir. 2007)), and for abuse of discretion if it is merely seeking review of a District Court's selection of remedies. *SEC v. Razmilovic*, 738 F.3d 14, 38 (2d Cir. 2013). With respect to the six arguments set forth below, Appellant maintains that all should be renewed *de novo* except for any evidentiary rulings.

II. Subject Matter Jurisdiction Is Lacking[4]

The SEC is a creature of statute, and consequently only has those powers Congress confers upon it. *Louisiana Pub. Serv. Comm'n v. F.C.C.*, 476 U.S. 355, 374 (1986); *Lyng v. Payne*, 476 U.S. 926, 937 (1986). With respect to enforcement proceedings, Congress has limited the SEC's powers through 28 U.S.C. § 2462, which provides that: "Except as otherwise provided by Act of Congress, an action,

[4] Although not raised below, "subject matter jurisdiction may be raised for the first time on appeal." *Update Art, Inc. v. Modiin Pub., Ltd.*, 843 F.2d 67, 72 (2d Cir. 1988).

suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued …." (Emphases added).

As the Supreme Court has explained: "By jurisdiction we mean power to entertain the suit, consider the merits and render a binding decision thereon; and by merits we mean the various elements which enter into or qualify the plaintiff's right to the relief sought." *Gen. Inv. Co. v. New York Cent. R. Co.*, 271 U.S. 228, 230 (1926) (emphasis added). As Congress has passed no statute permitting the federal courts to entertain untimely SEC enforcement actions tolled by private agreement, the District Court lacked subject matter jurisdiction.

Appellant acknowledges that this is an issue of first impression, but notes that commentators have questioned the ability of the SEC to contract around an otherwise unwaivable jurisdictional bar. *See, e.g., Ryan, Russell*, "What If SEC Tolling Agreements Are Unenforceable In Court?," *Law360* (July 24, 2020). "[U]nlike ordinary statutes of limitations, Section 2462 focuses not on when the plaintiff must do something but rather on whether the tribunal may or may not entertain the action or proceeding brought before it." *Id.* "In its most natural reading, Section 2462 literally forbids federal courts to entertain a category of cases unless a specific condition exists." *Id.* "In the context of Section 2462, tolling agreements serve essentially as contractual permission slips, signed by the SEC and a private party, that purport to empower courts to do something that Congress has plainly said they cannot do—namely, to entertain a case that seeks a fine, penalty or forfeiture based on a claim that first accrued more than five years earlier." *Id.*

While the issue remains unsettled, at least one federal court has held that Section 2462 is "a jurisdictional statute of limitation which operates to remove the Court's subject-matter jurisdiction to entertain cases not brought within the statutory time limit…" *SEC v. Graham*, 21 F. Supp. 3d 1300, 1311 (S.D. Fla. 2014), *aff'd in part, rev'd in part on other grounds and remanded sub nom.*, 823 F.3d 1357, 1362 n.1 (11th Cir. 2016). A mere statutory time bar, as opposed to a jurisdictional statute such as Section 2462, says nothing about a court's power to "entertain" an action, but instead refers only to the timeliness of a particular claim. *See United States v. Kwai Fun Wong*, 135 S. Ct. 1625, 1632 (2015). By contrast, the phrase "'shall not be entertained' … amounts to an 'unequivocal statutory command to federal courts not to entertain' an untimely claim." *Graham*, 21 F. Supp. 3d at 1308 (citing *Swain v. Pressley*, 430 U.S. 372 (1977)); *accord Williams v. Warden, Fed. Bureau of Prisons*, 713 F.3d 1332, 1339 (11th Cir. 2013) (holding that the "phrase 'shall not entertain' [in 28 U.S.C. § 2255(e)] yields the conclusion that Congress intended to, and unambiguously did strip … the court of subject-matter jurisdiction—in these circumstances unless the savings clause applies.").

Section 2462's legislative history supports the conclusion that the statute is intended to be jurisdictional and not merely a statute of limitation. "For more than a century, § 2462's predecessors simply provided that '[n]o suit or prosecution for any penalty or forfeiture, pecuniary or otherwise, accruing under the laws of the United States, shall be maintained' unless it is brought within five years 'from the time when the penalty accrued.'" *3M Co. (Minnesota Min. & Mfg.) v. Browner*, 17 F.3d 1453, 1458 (D.C. Cir. 1994) (emphasis added, quoting Revised Statutes § 1047, 18 Stat. 193, 193 (1874)). In 1948, however, Congress codified § 1047 of the Revised Statutes as 28 U.S.C. § 2462, and in the process, it changed the phrase "shall not be maintained" to the phrase "shall not be entertained." *Compare* Revised Statutes § 1047 with Act of June 25, 1948, c. 646, 62 Stat. 974.

At the time that § 2462 was codified, jurisdiction had long been characterized as a court's "power to entertain" a suit brought before it. *See, e.g.*, *Duhne v. State of New Jersey*, 251 U.S. 311, 314 (1920) (applying "the rule now so well settled as to be elementary, that the federal jurisdiction does not embrace the power to entertain a suit brought against a state without its consent"); *Fritzlen v. Boatmen's Bank*, 212 U.S. 364, 366 (1909) (stating that it was court's "plain duty to decline to take jurisdiction over a cause if the power to entertain it did not obtain"); *Swafford v. Templeton*, 185 U.S. 487, 489 (1902) (characterizing jurisdiction as "power to entertain the suit"). Thus, by amending the statute in this manner, Congress intended to set the jurisdictional limits of the federal courts.

In light of that fact, the key question here is, when did the SEC's cause of action accrue, and thus when did it expire in the absence of tolling agreements? In *Gabelli v. SEC*, 568 U.S. 442 (2013), the Supreme Court held the "standard rule" to be that a claim accrues "when the plaintiff has a complete and present cause of action." *Id.* at 448 (quoting *Wallace v. Kato*, 549 U.S. 384, 388 (2007)). Put another way, "an action accrues when the plaintiff has a right to commence it." *Id.* at 448 (citation omitted). "<u>Evidence of subsequent misconduct would not change the date at which the SEC had a complete and present cause of action</u>." *SEC v. Cohen*, 332 F. Supp. 3d 575, 588 n.6 (E.D.N.Y. 2018) (emphasis added).

When did the SEC have the right to commence this suit? The SEC answered that question at trial. In its opening arguments, its cross-examination of Appellant, its expert witness' testimony, and its summation, the SEC argued that its claim accrued in 2011, when Appellant signed up Robert Weathers and allegedly perpetrated a "scheme" of excessive trading in his account. Tr. 677-694. At trial, the SEC called Appellant to the stand, directed his attention to Exhibit PX1F-23, and proceed to walk him through a blotter showing 39 "excessive" transactions between May 10, 2011 and December 28, 2011. *Id.* at 685-691, 860-864.

In a different case, one in which the SEC broke out its claims by "victim," this might mean that only its claims as to Mr. Weathers would be time-barred. But here, the SEC prevailed on the District Court to treat this case as one where "the scheme is characterized as a single scheme," such that not all Investors would need to take the stand. SPA 86-87. As the SEC further explained:

> [I]n this specific case, there's no evidence … that any customer was treated differently. It was kind of a one-size-fits-all trading strategy and a one-size-fits-all scheme that involved the same acts from beginning to the end, the way they onboarded the customer, the prechecked boxes, and so on. I think if the jury finds that there's been liability, it would be … not just reasonable — but consistent with how courts deal with these cases routinely to assume they believed it as to … all of the customers.

Tr. 378-379. Indeed, that is what the Verdict reflects. SPA 64-66.

It is a foundational principle of our court system that, when "where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him." *Davis v. Wakelee*, 156 U.S. 680, 689 (1895). Here, the SEC obtained litigation advantages by trying this case as a "one-size-fits-all" scheme in which it did not distinguish among investors. As such, it had the right to commence suit in 2011, when Appellant supposedly perpetrated this alleged scheme on Mr. Weathers, a claim that expired in 2016.

In sum, subject matter jurisdiction is lacking. Accordingly, this entire case against Appellant should be dismissed with prejudice.

III. The District Court Erred In Allowing The SEC To Avoid The Pleading Elements Of Churning By Recharacterizing The Claims As "Suitability"

The gravamen of the SEC's case is that Appellant made excessive trades, in order to generate commissions at Investor expense. Appellant is not accused of having embezzled funds, sold swampland in Florida, or even made bad stock picks; rather, he is alleged to have traded in excess. However the SEC tries to dress it up, that is the sum and substance of the SEC's case. For example, here is how the SEC described the alleged "scheme to defraud": "[Appellant] launched [his] strategy of in-and-out trading, with sizable per-trade costs, using borrowed funds. The strategy was doomed from the start and the customers had no chance of earning even a modest profit." Dkt. 111 at 2. And here is how the SEC described the alleged "material misrepresentations and omissions": "[Appellant] concealed from [his] customers the fact that the cumulative impact of the per-trade costs would, in every instance, defeat any realistic chance of breaking even." *Id.*

As the Supreme Court has explained, "excessive trading … to generate commission income" is called "churning." *SEC v. Zandford*, 535 U.S. 813, 816 n.1 (2002). Here, the SEC could not prevail on a churning claim, because the thirteen Investors were financially sophisticated, affluent, and experienced in investing. They were self-proclaimed risk-tolerant investors who wanted to beat the market using (in the words of one Investor) "play money." Tr. 504.

That is significant because a required element of churning is that the customer yielded "control" of his or her account to the stockbroker. *See Newburger, Loeb & Co. v. Gross*, 563 F.2d 1057, 1069-70 (2d Cir. 1977). "[I]f a customer is fully able to evaluate his broker's advice and agrees with the broker's suggestions, the customer retains control of the account." *Id.* at 1070; *accord* FINRA Rule 2111 (providing that quantitative suitability, also known as churning, requires a broker to have "actual or *de facto* control over a customer's account").

To establish *de facto* control, the SEC would had to have demonstrated that each Investor's experience, education, decision-making, reliance, objectives and finances were such that Appellant effectively controlled their accounts. *See, e.g., In re Department of Enforcement*, Complainant Keith Howard Medeck, Respondent, 2009 WL 2424489, **9-11 (FINRA July 30, 2009) (reversing churning claim based on panel's failure to consider indicia of *de facto* control).

Rather than meet its evidentiary burden, *the SEC invented a new legal theory*. We know this because the SEC bragged about its inventiveness at the 2017 edition of its annual trade show, "SEC Speaks." As noted in a summary of the conference, Andrew M. Calamari (Co-Chair, Broker-Dealer Task Force and Regional Director, New York Regional Office) told the attendees that:

> [The SEC Enforcement] Division has developed a new theory for bringing actions against brokers for excessive trading in client accounts. Rather than relying on a theory that a broker controlled an account, the Division can also charge a broker under Section 17(a) and

> 10(b) for employing a trading strategy that is not suitable for the broker's client ….

See Ropes & Gray Alert: Securities & Future Enforcement, "The SEC Speaks 2017: Division of Enforcement Highlights" (March 13, 2017).[5] Lest there by any doubt as to who was the guinea pig in the SEC's new litigation experiment, Mr. Calamari made specific reference to Appellant's case as an example of "excessive trading" where the SEC's new theory was being utilized. *Id.*

After failing to win summary judgment, the SEC dropped its formal churning claim, but reframed the same excessive trading allegations under a make-shift "suitability" theory under FINRA Rule 2111. There are three suitability obligations under Rule 2111: quantitative suitability, reasonable-basis suitability, and customer specific suitability.[6] Because "quantitative suitability" pertains to excessive trading, and like churning, requires proof that the broker had *de facto* control over client accounts, the SEC rebranded its claim as "reasonable basis suitability." Thus, the SEC pushed forward with allegations of excessive trading under a theory that was

[5] https://www.ropesgray.com/en/newsroom/alerts/2017/03/The-SEC-Speaks-2017-Division-of-Enforcement-Highlights#Footnote_8.

[6] According to FINRA, quantitative suitability requires a broker with actual or *de facto* control over a customer's account to have a reasonable basis for believing that an investment recommendation, even if suitable in isolation, is not excessive and unsuitable for the customer when taken together in light of the customer's investment profile. Reasonable-basis suitability, in turn, requires a broker to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors. Finally, customer-specific suitability requires a broker, based on a particular customer's investment profile, to have a reasonable basis to believe that the recommendation is suitable for that customer. *See FINRA Rules & Guidance: Suitability* (https://www.finra.org/rules-guidance/key-topics/suitability).

not applicable to its case, in order to avoid having to prove at trial that Appellant had *de facto* control over the Investors' accounts.

Appellant objected to this in his *in limine* motion, but the District Court nonetheless allowed the SEC to proceed with this make-shift suitability theory, while precluding Appellant from introducing evidence at trial of *de facto* control. Under prevailing legal precedent, the District Court should have either: (a) precluded the SEC from offering evidence of excessive trading/churning/quantitative suitability, or else (b) required the SEC to prove the *de facto* control element required for its excessive trading/churning/quantitative suitability claims. This legal error poisoned the trial, and accordingly the Verdict should be set aside.

IV. The District Court Erred In Allowing The SEC To Assert "Unauthorized Trades" For Investors Who <u>Never Accused Appellant Of Any Such Thing</u>

At trial, the SEC prevailed on its charge that Appellant, *with scienter*, made unauthorized trades in twelve of thirteen Investor accounts. It won this Verdict even though only three of those Investors took the stand to testify at trial.

The Sixth Amendment right to face one's accuser admittedly does not extend to SEC civil actions. *See SEC v. Curshen*, 2013 WL 411367, *3 (S.D.N.Y. Feb. 1, 2013). Still, due process requires *there at least <u>be</u> an accuser*. Here, for the most part, there was not. The jury's Verdict as to non-testifying Investors is thus a "manifest injustice," as it is "wholly without legal support." *Sojak v. Hudson*

Waterways Corp., 590 F.2d 53, 54 (2d Cir. 1978).

The District Court came to a similar conclusion in *E. F. Hutton & Co. v. Penham*, 547 F. Supp. 1286 (S.D.N.Y. 1982). In that case, the plaintiff (like the SEC here) sought to prove, without actual customer testimony, that the broker defendant had made unauthorized trades in customer accounts through a secondhand analysis of "business records" (again like the SEC here). *Id.* at 1293. The District Court rejected plaintiff's business records as "self-serving documents prepared … in support of his version of the facts," holding that: "[t]o allow these documents as proof that the trades were in fact unauthorized … would relieve [plaintiff] of its burden to produce the customers themselves [and] would render an unacceptable injustice on [defendant]." *Id.* at 1293-1294. Thus, its claim for unauthorized trading in customer's accounts was dismissed. *Id.* at 1295.

Unfortunately in this case, the District Court was more forgiving. It permitted the SEC to lower the evidentiary bar, by putting forward a junk-science analysis of phone records to "prove" lack of authorization by non-testifying Investors. The allegation was dubious on its face, given that every J.D. Nicholas customer received immediate confirmations (by mail and online) of every trade. Tr. 139. Yet none of these Investors who received these confirms ever made a contemporaneous allegation of unauthorized trades. Rather, it took the SEC, and its statistical analysis of telephone records, to arrive at this conclusion.

Indeed, those Investors whom the SEC did put on the stand totally undercut the SEC's claim. First to take the stand was Clay Miller. According to the SEC's analysis of phone records, Appellant made 31 unauthorized trades for Mr. Miller. PX-28A. But when he was asked directly: "Did Mr. Fowler ever put any unauthorized transactions in your account?," Mr. Miller answered: "No, not to my knowledge." Tr. 202. Next up was Allen Deuschle. According to the SEC, Appellant made 109 unauthorized trades for Mr. Deuschle. At trial, however, Mr. Deuschle confirmed he gave Appellant "prior authorization to trade [his] account without having to contact [him] first." *Id.* at 477. Last up was Lane Clizbe, who admitted that: "Q. … Is it fair to say, based on those responses, that you don't have a complete recollection of all the conversations you had with Don Fowler? … A. That's fair." *Id.* at 549. In sum, the only way for the SEC to establish any sort of unauthorized trading was through a secondhand analysis of phone records.

Basically, the SEC's phone record analysis went as follows. First, it examined the trading blotter for an Investor. Then, it compared that blotter against subpoenaed J.D. Nicholas phone records, to see if each trade "was preceded by a call [between that Investor and Appellant] on the day of the trade." *Id.* at 284.

There are a number of flaws in this "analysis." First, it depends on the completeness of the subpoenaed phone records. In reality, they were woefully *incomplete*. Indeed, the phone records were produced with a legend saying:

"Lightpath inbound Call Detail Records … contain only call detail information with which Lightpath keeps in the regular course of its business and may not be a complete record of all inbound calls." *Id.* at 290. Also, for several J.D. Nicholas numbers, Lightpath (the phone provider) stated that: "the outbound calls details for the numbers referenced in the subpoena came back empty." *Id.* at 292. The SEC never bothered to learn why. *Id.* Perhaps most importantly, the SEC also never bothered to subpoena <u>the Investors'</u> phone records, *nor even ask the Investors for a complete set of numbers they might have used to make trades*. *Id.* at 294-95. Instead, the SEC had one of its employees use Google and other documents and databases to try to piece together Investor phone numbers. *Id.* at 92.

Ordinarily, incomplete phone records might still be usable for impeachment, as an aid to the jury in weighing witness credibility. But here, the SEC, with its near-limitless resources, made the tactical decision not to call ten of thirteen Investors, and the District Court, over Appellant's objections, let it slide. Given how the three Investors the SEC did call testified, one can hardly blame the SEC. But there is simply no evidence that Appellant, *with scienter*, made unauthorized trades in any Investor accounts. As in *E. F. Hutton, supra,* the District Court should have thrown out the claim. Instead, it let the matter go to a jury and then, based on this utterly contrived "evidence," penalized Appellant $150,000 per Investor. As the outcome is manifestly unjust, this Court should reverse it.

V. The District Court Circumvented The Maximum Penalty Set By Congress By Multiplying The Cap By Fifteen

The Amended Complaint asserts, and the SEC prevailed, on two Claims for Relief, one under the Exchange Act under a "scienter" standard and the other under the Securities Act under a "negligence" standard.[7] In seeking penalties, however, and in trying its underlying case, the SEC repeatedly made it clear that Appellant's alleged misconduct was all in furtherance of a single "scheme," as opposed to thirteen separate schemes against thirteen distinct Investors.[8]

Where, as here, a defendant is found to have "violated a number of securities laws in carrying out a single scheme … courts generally have imposed a single penalty." *SEC v. Locke Capital Mgmt., Inc.*, 794 F. Supp. 2d 355, 370 (D.R.I. 2011); *accord, e.g., SEC v. Johnston*, 368 F. Supp. 3d 247, 255 (D. Mass. 2019) (finding that participation in a "scheme to defraud warrants a single penalty"); *SEC v. Madsen*, 2018 WL 5023945, *5 (S.D.N.Y. Oct. 17, 2018) (treating "Madsen's short-lived scheme … as a single 'violation' within the meaning of the Remedies Act."); *SEC v. Riel*, 282 F. Supp. 3d 499, 529 (N.D.N.Y. 2017) ("Since the violations here

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7 Question 1 of the Verdict Sheet offered Section 17(a)(1) of the Securities Act as an alternative scienter claim to Section 10(b) and Rule 10b-5 under the Exchange Act, but did not require the jury to make separate findings as to the two statutes, instead connecting them with an "or." Thus, Question 1 does not provide a basis for more than one statutory violation.

8 *See, e.g.,* SEC Penalty Br. at 6 ("Fowler lured fourteen customers with a bait-and-switch scheme."); at 14 ("Fowler acted with the utmost degree of scienter … from the outset of his fraudulent scheme, through his attempts to conceal it from customers, and given his motives to engage in the scheme in the first place."); at 24 ("But the jury's verdict was conclusive as to Fowler's misdeeds and, in particular, his fraudulent scheme.").

arose out of a single scheme or plan, for purposes of this case the Court will apply a single monetary penalty"); *SEC v. Garfield Taylor, Inc.*, 134 F. Supp. 3d 107, 110 (D.D.C. 2015) ("Because the violations here similarly arose out of a single scheme or plan, … the Court will apply a single monetary penalty"); *SEC v. GTF Enterprises, Inc.*, 2015 WL 728159, **4-5 (S.D.N.Y. Feb. 19, 2015) (imposing "a single penalty against each Defendant for the entirety of the scheme" even though "ten investor victims invested money with Defendants in sixteen transactions"); *SEC v. Brown*, 643 F. Supp. 2d 1088, 1093 (D. Minn. 2009) ("Although Defendants' conduct violated three separate statutes, it was essentially a single course of conduct"), *aff'd*, 658 F.3d 858 (8th Cir. 2011); *SEC v. Rabinovich & Assocs., LP*, 2008 WL 4937360, *6 (S.D.N.Y. Nov. 18, 2008) ("Although [defendant] engaged in repeated violations of the securities laws, they all arose from a single scheme or plan. A [single penalty] is therefore appropriate in this case.").

The District Court rejected this line of cases, holding that "treating each of his defrauded customers as a separate violation best effectuates the purposes of the statute" because "Mr. Fowler argued throughout the trial [that] he approached each of his customers individually." SPA 86. While Appellant did make that argument, the jury—based on its answer to, *inter alia* Verdict Question #5—instead adopted the SEC's claim of one "scheme." The District Court should have assessed penalties based on the Verdict, not on defenses the jury did not adopt.

At worst, there should be only two penalties, one of no more than $7,500 for the First Tier negligence count and the other of no more than $150,000 for the Third Tier scienter count (as adjusted under 17 C.F.R. § 201.1001). Instead, the District Court imposed a financially ruinous thirteen $150,000 penalties upon Appellant, on the theory that it had been vested with unfettered "discretion" under 15 U.S.C. § 77t(d)(2)(C) to impose the maximum penalty for each and every "victim." SPA 84-87. That is not at all what Congress intended by that statute.

In 1990, Congress expanded the SEC's enforcement remedies, authorizing the agency to seek civil penalties in federal district courts for any violation of the federal security statutes. *See* Securities Enforcement Remedies and Penny Stock Reform Act, Pub. L. No. 101-429, §§ 101, 202, 104 Stat. 931, 932–33, 937–38 (1990) (codified at 15 U.S.C. §§ 77t, 78u-2). (The SEC has spent the last four decades engaged in creative lawyering to expand these remedies, forcing courts to step in periodically to rein in the agency.) Nothing in the *voluminous* legislative history of that Act suggests Congress intended for the statutory penalty caps to be applied "per victim," which in most cases would render the cap limitless.

While the District Court correctly noted that the statute does not expressly define the term "violation," that does not give the federal courts *carte blanche* to define that term by virtue of their discretion. Rather, they should construe legislative intent "by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole." *Kar Onn Lee v. Holder*, 701 F.3d 931, 936 (2d Cir. 2012) (citation omitted). As this Court has taught: "In interpreting the statute at issue, we consider not only the bare meaning of the critical word or phrase but also its placement and purpose in the statutory scheme." *Id.* (citing *Holloway v. United States*, 526 U.S. 1, 6 (1999)). Of significance here, "Congress's failure to grant an agency a given power is not an ambiguity as to whether that power has, in fact, been granted. On the contrary, . . . a statutory silence on the granting of a power is a *denial* of that power to the agency." *Am. Bus Ass'n v. Slater*, 231 F.3d 1, 8 (D.C. Cir. 2000) (Sentelle, J., concurring).

Under the statute, a Third Tier penalty (as opposed to First or Second) may only be imposed if "such violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other *persons*." 15 U.S.C. § 77t(d)(2)(C)(II) (emphasis added). The clear implication is that when multiple investors are affected, the appropriate remedy is to upgrade the penalty from Second to Third Tier, *not* multiply it for each affected investor.[9] Alternatively, the $150,000 cap may be exceeded to the extent of: "the gross amount of pecuniary gain to such

[9] Indeed, that is how Congress, in its legislative history, envisioned the penalty statute would function. *See, e.g.*, Report of the Committee on Banking, Housing and Urban Affairs United States Senate on S. 647, 101 Cong. 13 (1989) ("Thus, for example, if a violation involves fraud and resulted in substantial losses to other persons, a court (in addition to ordering disgorgement of profits) may assess a civil penalty equal to a violator's gain, even when that gain exceeds the applicable $100,000 [natural person] limitation.") (emphasis added).

defendant as a result of the violation." 15 U.S.C. § 77t(d)(2)(C).

Indeed, Congress differentiated "violations" from "acts and omissions" in establishing penalties, and thus did not intend the terms to be interchangeable. While the penalty statute authorizes the imposition of monetary penalties for each "violation" in civil actions, 15 U.S.C. § 77t(d), the monetary penalty the SEC can impose in administrative proceedings is instead based on each "act or omission." 15 U.S.C. § 80a-9(d)(2)(C). *See SEC v. McCarthy*, 322 F.3d 650, 656 (9th Cir. 2003) ("It is a well-established canon of statutory interpretation that the use of different words or terms within a statute demonstrates that Congress intended to convey a different meaning for those words.") (collecting cases).

Rather, when Congress has wanted to increase penalties based on the number of alleged victims, it has done so expressly. The Federal Sentencing Guidelines for fraud crimes, for example, provide for the offense level of the crime to be increased based on the number of victims. *See* U.S.S.G. § 2B1.1(b)(2).[10] Similarly, in its very own regulations, the SEC distinguishes between "number of violations" and "number of individuals harmed by the violations," placing them in two separate categories under 17 C.F.R. § 202.12(b) in assessing cooperation:

(1) The character of the Investigation including…: (i) Whether the

[10] "If the offense—(A)(i) involved 10 or more victims; (ii) was committed through mass-marketing; or (iii) resulted in substantial financial hardship to one or more victims, increase by 2 levels; (B) resulted in substantial financial hardship to five or more victims, increase by 4 levels; or (C) resulted in substantial financial hardship to 25 or more victims, increase by 6 levels."

> subject matter of the Investigation is a Commission priority; (ii) The type of securities violations; (iii) The age and duration of the misconduct; (iv) ***The number of violations***; and (v) The isolated or repetitive nature of the violations.
>
> (2) The dangers to investors or others presented by the underlying violations involved in the Investigation including…: (i) The amount of harm or potential harm caused by the underlying violations; (ii) The type of harm resulting from or threatened by the underlying violations; and (iii) ***The number of individuals or entities harmed***.

(Emphases added.) In sum, even the SEC knows the number of investors affected by a violation is not the same issue as the number of violations.

The District Court cited five cases in support of multiplying the maximum penalty by thirteen. However, each of those cases was generally decided without analysis or objection, and in none of them were penalties amplified to fifteen times above the pecuniary gain. For example, in *SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 287-288 (2d Cir. 2013), this Court vacated a penalty that had been set at an amount equal to the disgorgement. In *SEC v. Elliot*, 2012 WL 2161647, *11 (S.D.N.Y. June 12, 2012), where approximately $3.5 million had been misappropriated, the District Court imposed only an indeterminate penalty. In *SEC v. Glantz*, 2009 WL 3335340, *6 (S.D.N.Y. Oct. 13, 2009), where $2 million was misappropriated, the District Court imposed only a $200,000 penalty. In *SEC v. Milan Capital Grp., Inc.*, 2001 WL 921169, **3-4 (S.D.N.Y. Aug. 14, 2001), where nearly $8.4 million was misappropriated, the District Court imposed a $10 million penalty, albeit jointly upon two defendants. And in *SEC v. Kenton Capital, Ltd.*, 69

F. Supp. 2d 1, 17 (D.D.C. 1998), where $1.745 million was misappropriated, the District Court imposed only a $1.2 million penalty.

Lastly, and in any event, even if the District Court legally had discretion to assess penalties based on number of "victims," it would be an abuse of that discretion to impose penalties that equate to fifteen times the disgorgement amount, as the District Court did here. *See, e.g., SEC v. Cole*, 2014 WL 4723306, *6 (S.D.N.Y. Sept. 22, 2014) (disgorgement amount "is a helpful starting point to calculate" civil penalty), *aff'd*, 661 F. App'x 52 (2d Cir. 2016); *SEC v. GTF Enterprises*, *supra* at *2 (S.D.N.Y. Feb. 19, 2015) ("disgorgement amount is a 'helpful starting point'"). In sum, the $1.95 million penalty should be vacated, and replaced with a maximum civil monetary penalty or no more $157,500.

VI. The Civil Penalty Also Violates The Fifth And Eight Amendments

Further, even if Congress, in enacting 28 U.S.C. § 2462, did intend to leave it to the federal courts to decide what constitutes a violation (and thus if the maximum penalty has any meaning at all), any penalty would still have to pass Constitutional muster. As this Court explained in *New York v. United Parcel Serv., Inc.,* 942 F.3d 554, 600 (2d Cir. 2019): "the fact that the district court's penalty award is technically permissible under the statutory regimes at play does not necessarily mean that it is a reasonable penalty in all circumstances. Penalties cascading on a defendant from several different statutory regimes must be applied with great care when they result from one underlying set of bad actions."

The Fifth Amendment provides in relevant part that: "No person shall be … deprived of life, liberty, or property, without due process of law …." U.S. Const., Amdt. 5. The Eighth Amendment, in turn, provides: "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." U.S. Const., Amdt. 8. The federal courts have not been shy in using these safeguards to curb overly punitive fines. *See, e.g.*, *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 568 (1996) (holding that grossly excessive punitive damage awards can violate Due Process Clause); *United States v. Bajakajian*, 524 U.S. 321, 334 (1998) (holding that punitive forfeiture violates Excessive Fines Clause of the Eight Amendment if it is "grossly disproportional to the gravity of a defendant's offense"); *see also SEC v. Amerindo Inv. Advisors*, 639 F. App'x 752, 755 (2d Cir. 2016) (applying the *Bajakajian* factors to the review of an SEC civil penalty).

As a practical matter, these two Constitutional protections are often analyzed in tandem with one another. In *Cooper Ind., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 434-35 (2001), for instance, the Supreme Court held that: "the relevant constitutional line is 'inherently imprecise,' …. But in deciding whether that line has been crossed, we have focused on the same general criteria: the degree of the defendant's reprehensibility or culpability…; the relationship between the penalty and the harm to the victim caused by the defendant's actions…; and the sanctions imposed in other cases for comparable misconduct..." (citations omitted). In *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 23-24 (1991), for example, the Supreme Court concluded that a punitive damages award of "more than 4 times the amount of compensatory damages" might be "close to the line," but did not "cross the line into the area of constitutional impropriety." (Emphasis added.) In this case, the penalties imposed by the District Court equal fifteen times Appellant's gross monetary gain from the alleged wrongdoing, as calculated by the District Court. That not just crosses the line, but obliterates it.

The penalty should thus be vacated, consistent with Constitutional mandates, and remanded for a reassessed penalty not grossly disproportionate to the $132,076 that Appellant supposedly earned on the accused trades. In addition, on remand, the District Court should be further guided by the other factors identified by this Court in *New York v. United Parcel Serv., Inc.*, 942 F.3d 554, 599, including "the defendant's ability to pay." Imposing a $2 million punitive penalty on a small-time stockbroker for "excessive trading" (despite the SEC's overheated rhetoric) is excessive, unjust, and a stain on our civil justice system.

VII. The Disgorgement Amount Should Be Remanded To Deduct Expenses

Lastly, there is the issue of disgorgement. As noted above, the District Court in its Penalties Order directed Appellant to disgorge $132,076 (plus interest), representing $104,568.40 in commissions and $27,498 in postage fees he received from the Investors. SPA 81. Appellant takes no issue with this calculation, in and of itself, except that the District Court did not deduct legitimate business expenses, even though the SEC stipulated that: "Fowler and Dean set up a partnership … to pay expenses of their brokerage operation …." JX-6 ¶54.

As the District Court explained: "In making the disgorgement calculation, the proper focus is revenues, not profits. … Defendants are not entitled to deduct costs associated with committing their illegal acts." SPA 80 (internal quotation marks omitted). That may have been a correct recitation of the law as it existed when the Penalties Order was issued, but there has been an intervening change in the law, courtesy of the Supreme Court, which this Court may consider on appeal. *See Holsinger v. Valley Hosp.*, 646 F.2d 792, 796 (2d Cir. 1981).

Specifically, in *Liu v. SEC*, 140 S. Ct. 1936, 1949-50 (2020), the Supreme Court focused for the first time on the SEC's disgorgement power. In so doing, it placed an important restriction on that particular remedy:

> Courts may not enter disgorgement awards that exceed the gains "made upon any business or investment, when both the receipts and payments are taken into the account." ... Accordingly, courts must deduct legitimate expenses before ordering disgorgement under §78u(d)(5). A rule to the contrary that "make[s] no allowance for the cost and expense of conducting [a] business" would be "inconsistent with the ordinary principles and practice of courts of chancery."

Id. (citations omitted). In light of *Liu*, the Penalties Order should be remanded to recalculate disgorgement, taking into account Appellant's expenses.

CONCLUSION

For the foregoing reasons, the Judgment below should be reversed, and either the entire case dismissed for lack of subject matter jurisdiction, or else the securities law violations vacated in all respects, and/or the penalty and disgorgement reversed and remanded for further proceedings consistent herewith.

Dated: New York, New York
August 6, 2020

EMMET, MARVIN & MARTIN, LLP

By: ______________________

John Dellaportas
Beth Claire Khinchuk
120 Broadway
New York, NY 10271
Tel 212.238.3000
Attorneys for Defendant-Appellant
Donald J. Fowler

CERTIFICATE OF COMPLIANCE WITH
LOC. R. 2d CIR. APP. P. 28.1 AND FED. R. APP. P. 32(a)

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Dated: New York, New York
August 6, 2020

s/ John Dellaportas

20-1081-cv

17-cv-139(SDNY)

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

Securities and Exchange Commission,

Plaintiff-Appellee,

—against—

Donald J. Fowler,

Defendant-Appellant,

Gregory T. Dean,

Defendant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

SPECIAL APPENDIX FOR DEFENDANT-APPELLANT DONALD J. FOWLER

John Dellaportas
Beth Claire Khinchuk
EMMET, MARVIN & MARTIN, LLP
120 Broadway
New York, New York 10271
(212) 238-3100

Attorneys for Defendant-Appellant Donald J. Fowler

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

GREGORY T. DEAN,
DONALD J. FOWLER,

Defendants.

------------------------------x

New York, N.Y.

17 Civ. 139 (GHW)

May 22, 2019
4:05 p.m.

Before:

HON. GREGORY H. WOODS,

District Judge

APPEARANCES

SECURITIES AND EXCHANGE COMMISSION
BY: DAVID STOELTING
JORGE G. TENREIRO
KRISTIN M. PAULEY
THOMAS P. SMITH

McCORMICK & O'BRIEN, LLP
Attorneys for Defendants
BY: LIAM O'BRIEN

(Case called)

THE COURT: This is Judge Woods. Do I have counsel for plaintiff on the line?

MR. STOELTING: Yes, your Honor.

THE COURT: Good. Thank you. Can I ask you to please identify yourselves?

MR. STOELTING: Yes, your Honor.

For plaintiff, David Stoelting, Jorge Tenreiro, Kristin Pauley, Tom Smith, and also with us is Jordan Liberman, who is a law school summer intern this summer.

THE COURT: Good. Thank you very much.

Do I have counsel for defendants on the line?

MR. O'BRIEN: Yes, your Honor.

THE COURT: Thank you. Can I ask you to please identify yourself?

MR. O'BRIEN: Sure, Liam O'Brien and Harry Deladramatikin.

THE COURT: Thank you.

I don't see that Mr. Deladramatikin has entered a notice of appearance; has he?

MR. O'BRIEN: He has not, your Honor. He is just attending to assist me.

THE COURT: Thank you.

Is he planning to appear in the case?

MR. O'BRIEN: I don't believe so, your Honor.

THE COURT: Fine.

So, if he is going to be representing any party here, he must enter a notice of appearance.

Counsel, I scheduled this conference on relatively short notice to discuss the motions *in limine* and the Daubert motion. My expectation is to rule on all of them here during the course of the conference verbally in order to give you answers with respect to these issues promptly. I'm sorry that we weren't able to do it during the course of the conference last week but, as you could tell, time was short and this may take some time.

Counsel, I have reviewed all of the submissions by the parties. I would be happy to hear if either side would like to add any additional arguments, but otherwise I believe that I am prepared to rule with respect to each of the pending motions. As I said, I expect that this may take some time, there are a number of lawyers on the phone. I welcome you all. But, at the same time, to the extent any one of you wants to get the summary from your colleagues or more colleagues at some point later, I will not be offended if you choose to step out. Indeed, I will likely not even know that.

So, counsel, first for plaintiff is there anything that you would like to add to your written submissions in connection with the motions *in limine* or the Daubert motion?

MR. STOELTING: Thank you, your Honor.

We appreciate the opportunity, but we will rest on our written submissions at this point.

THE COURT: Good. Thank you.

Counsel for defendants?

MR. O'BRIEN: We will do the same, your Honor.

THE COURT: Good. Thank you very much.

So, I'm going to ask you to place your phones on mute. As I said, I'm going to deliver these opinions orally. In the aggregate, it is a lot of pages of decision so, please, bear with me. I would also ask that you place your phones on mute on your end of the phone unless and until I ask you to speak. I will provide an appropriate prompt for you to do so.

So, let me begin with the motions *in limine*. I will begin first with an overview of the motions.

On April 1, 2019, the parties in this case filed their respective motions *in limine*. Defendants filed three motions. The first motion seeks to preclude the SEC from introducing the testimony of Mr. Bernardo, one of the defendant former customers. Docket no. 101. Defendants' second motion seeks to exclude evidence related to complaints, lawsuits, and arbitrations that non-party customers have filed against defendants. Docket no. 102. Defendants' third motion asks the Court to exclude evidence related to alleged unauthorized trades, unsuitability, and churning. Docket no. 103. The SEC filed its opposition to those motions on April 11, 2019.

Docket no. 16. Defendants filed their reply brief on April 18, 2019. See docket nos. 119 to 121.

The SEC filed one motion in limine. Docket no. 107. This motion asks the Court to preclude defendants from introducing evidence related to the sophistication of defendants' customers, post-investment disclosures, and certain SEC communications. Defendants filed an opposition to this motion on April 11, 2019. Docket no. 115. The SEC filed its reply on April 1, 2019. Docket no. 122.

I will first set out the legal standards that apply to both parties' motions. I will then briefly describe the law governing the claims that the search elements of the claims that SEC has asserted against defendants. Then I will address the motions one by one.

First, legal standards.

Motions *in limine*. "'The purpose of an in limine motion is to aid the trial process by enabling the Court to rule in advance of trial on the relevance of certain forecasted evidence, as to issues that are definitely set for trial, without lengthy argument at, or interruption of, the trial.'" Hart v. RCI Hosp. Holdings, Inc., 90 F. Supp. 3d 250, 257-58 (S.D.N.Y. 2015) (quoting Highland Capital Mgmt., L.P. v. Schneider, 551 F. Supp. 2d 173, 176 (S.D.N.Y. 2008)). "Evidence should not be excluded on a motion in limine unless such evidence is 'clearly inadmissible on all potential grounds.'" Id. (quoting Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. L.E. Myers Co. Grp., 937 F. Supp. 276, 287 (S.D.N.Y.1996)).

Federal Rules of Evidence.

The Federal Rules of Evidence govern the admissibility of evidence at trial. Under Rule 402, evidence must be relevant to be admissible. Fed. R. Evid. 402. The "standard of relevance established by the Federal Rules of Evidence is not high." United States v. Southland Corp., 760 F.2d 1366, 1375 (2d Cir. 1985). If the evidence has "any tendency to make a fact more or less probable than it would be without the evidence" and "the fact is of consequence in determining the action," it is relevant. Fed. R. Evid. 401. Nonetheless, under Rule 403, relevant evidence may be excluded if "its probative value is substantially outweighed by a danger of one or more of the following: Unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence." Restivo v. Hessemann, 846 F.3d 547, 572-73 (2d Cir. 2017).

"Evidence is prejudicial under Rule 403 if it 'involves some adverse effect . . . beyond tending to prove the fact or issue that justified its admission into evidence.'" Highland Capital Mgmt., L.P. v. Schneider, 551 F. Supp. 2d 173, 176- 77 (S.D.N.Y. 2008) (quoting United States v. Gelzer, 50

F.3d 1133, 1139 (2d Cir. 1995)). "The Court will exclude such evidence if it has 'an undue tendency to suggest decision on an improper basis.'" Id. (quoting Fed. R. Evid. 403, advisory committee's notes).

The Second Circuit has explained that the "[d]istrict courts have broad discretion to balance probative value against possible prejudice" under Rule 403. United States v. Bermudez, 529 F.3d 158, 161 (2d Cir. 2008) (citation omitted).

Federal Rule of Evidence 404(b) provides that "[e]vidence of a crime, wrong, or other act is not admissible to prove a person's character in order to show that on a particular occasion the person acted in accordance with the character." However, the "evidence may be admissible for another purpose, such as proving motive, opportunity, intent, preparation, plan, knowledge, identity, absence of mistake, or lack of accident." FRE 404(b). "The Second Circuit's 'inclusionary' rule allows the admission of such evidence 'for any purpose other than to show a defendant's criminal propensity, as long as the evidence is relevant and satisfies the probative-prejudice balancing test of Rule 403 of the Federal Rules of Evidence.'" United States v. Greer , 631 F.3d 608, 614 (2d Cir. 2011) (quoting United States v. Inserra, 34 F.3d 83, 89 (2d Cir. 1994)). " The district court has wide discretion in making this determination . . . ." United States v. Carboni, 204 F.3d 39, 44 (2d Cir. 2000).

Suitability. Because this issue is relevant to certain of the analysis that I'm going to be describing momentarily, I would like to lay out a description of certain of the suitability requirements.

Under FINRA Rule 2111, a "member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer." Rule 2111 establishes three categories of suitability obligations. The first, called Reasonable-Basis Suitability, "requires a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors." Rule 2111.05(a). The second, called Customer-Specific Suitability, requires "that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile." Rule 2111.05(b). Finally, Quantitative Suitability "requires a member or associated person who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile." Rule 2111.05(c). A cause of action based on Quantitative Suitability requires two elements of proof that are not necessary under either Reasonable-Basis Suitability or Customer-Specific Suitability. See IN THE MATTER OF DEPARTMENT OF ENFORCEMENT, COMPLAINANT KEITH HOWARD MEDECK, RESPONDENT, 2009 WL 2424489, at *10. The first of these elements is broker control over the account in question. Control "is satisfied if the broker has either discretionary authority or de facto control over the account." Id. De facto control "is established when the client routinely follows the broker's advice because the customer is unable to evaluate the broker's recommendations and to exercise independent judgment." Id. (internal citation and quotation marks omitted). The second element is excessive trading activity inconsistent with the customer's financial circumstances and investment objectives. Id.

Discussion.

Defendants have filed three motions *in limine* and plaintiffs have filed one. The Court discusses each of these motions below.

First, defendants' motions *in limine*.

Defendants' motion to exclude the testimony of Eugene Bernardo.

Defendants seek to exclude the testimony of Eugene Bernardo, one of Defendants' customers, on the grounds that he is "incompetent to testify." Dkt. No. 101 at 2. Defendants argue that Mr. Bernardo is incompetent to testify because, they claim, he suffers from "several medical disorders which affect his health and render his memory unreliable." Id. In support of this claim, Defendants cite passages from Mr. Bernardo's deposition in which he describes his health challenges and references his issues with his memory. In his deposition, for example, Mr. Bernardo states that he "has a memory problem," Dkt. No. 101, Ex. 1 at 218: 10-14, and, in another exchange with examining counsel, explains that his "mind isn't too good." Id. at 26:3-4.

In light of Mr. Bernardo's alleged incompetence, Defendants argue that any probative value that his testimony offers is outweighed by the unfair prejudice Defendants would suffer if the Court fails to exclude his testimony.

Federal Rule of Evidence 601 provides: "Every person is competent to be a witness except as otherwise provided in these rules." Fed. R. Evid. 601. In general, the competence of a witness to testify depends upon the witness's capacity to observe, remember, communicate and understand the nature of the oath and the duty it imposes to tell the truth. Diaz v. Mazzuca, No. 00 CIV 4843 SAS, 2001 WL 170662, at *3 (S.D.N.Y. Feb. 21, 2001) (internal citations and quotation marks omitted); see also United States v. Roman, 884 F. Supp. 126, 127 (S.D.N.Y.1995); United States v. Bloome, 773 F. Supp. 545, 546-47 (E.D.N.Y. 1991). In light of FRE 601's presumption of a witness's competence to testify, the Court cannot conclude that

Mr. Bernardo is incapable of meeting the competence standard as articulated in Diaz. The fault of recollection cited to by defendants is insufficient for the Court to conclude on the basis of his deposition testimony alone that Mr. Bernardo lacks adequate capacity to testify under the standard established under the case law.

In addition, to the extent that defendants argue that permitting a frail witness to testify on behalf of plaintiffs will be unduly prejudicial to them because it will present the customer as being a frail person. I don't believe that the prejudicial effect of that such testimony substantially outweighs the probative value of this evidence and, as a result, I don't believe that it is appropriately excluded under Rule 403. For these reasons, defendants' motion to preclude the testimony of Mr. Bernardo is denied.

Defendants' motion to exclude arguments or evidence related to other customer disputes including lawsuits or arbitrations.

The Court understands that the SEC intends to introduce evidence and testimony concerning claims, lawsuits, and arbitrations that non-party customers raised against Defendants (the "Customer Complaints") as reflected in their FINRA Central Registration Depository ("CRD") records. Dkt. No. 102.

Defendants seek to preclude the SEC from offering any evidence or testimony regarding the complaints for four fundamental reasons.

First, defendants argue that this evidence is not relevant because it is not related to the specific transactions that form the basis of the SEC's allegations against them. Second, defendants claim that any reference to the rulings in this, with respect to this evidence, should be excluded as inadmissible hearsay. Third, defendants argue that this information is unfairly prejudicial to them because there is a considerable risk that the jury will infer from this evidence that they had a propensity to defraud individuals, or that these allegations constitute evidence of routine or habit.

Finally, defendants argue that permitting the SEC to introduce this evidence and testimony will require the Court to conduct mini trials concerning the claims and actions asserted by these other non-party customers which will needlessly complicate and lengthen the trial.

In its opposition, the SEC explains that it seeks to introduce evidence and testimony regarding the customer complaints for the sole purpose of demonstrating that defendants were "on notice" about the complaints against them. It is the SEC's position that the customer complaints speak to defendants' scienter. Docket no. 116 at 21. The SEC's argument, writ broadly, is as follows: The customer complaints, which again allegedly consist of lawsuits, arbitrations, and other claims by non-party customers against defendants for executing unauthorized trades and excessive trading, allow the jury to infer that defendants were reckless and that they had knowledge that their strategy was not suitable for any investor. Docket no. 116 at 21.

So, customer complaints that were filed by customers before and concurrent to the events giving rise to the claims at issue in this case are clearly relevant. If non-party customers lodged complaints against defendants for executing trades or managing their accounts in a manner similar to the way in which defendants allegedly managed the accounts of the customers in this case, that evidence speaks to defendants' knowledge. Because scienter is an element of plaintiffs claims the Court readily concludes that the evidence is relevant.

Now, defendants suggest that the introduction of this evidence is akin to "other acts" evidence precluded under Rule 404(b). To that extent, the challenge fails. In order to assess the admissibility of the evidence of "other acts" under Rule 404(b), the Court follows a multi-step process:

"First the District Court must determine if the evidence offered is offered for proper purpose, one other than to prove the defendant's bad character or criminal propensity. If the evidence is offered for a proper purpose, the District Court must next determine if the evidence is relevant to an issue in the case and, if relevant, whether its probative value is substantially outweighed by the danger of unfair prejudice. Finally, upon request, the District Court must give an appropriate limiting instruction to the jury.

United States v. Pitre, 960 F.2d 1112, 1119 (2d Cir. 1992); accord United States v. Schlussel, No. 08-cr-694 (JFK), 2008 WL 5329969, at *2 (S.D.N.Y. Dec. 15, 2008).

Here, again the essence of plaintiff's argument is that the evidence of customer complaints is not that they are offered to prove that defendants acted in accordance with and consistent with bad character. Instead, it offers the evidence to demonstrate defendants' scienter, that is, their knowledge of the unsuitability of the strategy that they had recommended. This evidence can tend to show the defendants' intent, plan, knowledge, absence of mistake and, as a result, the evidence is offered for a proper purpose under the Second Circuit's inclusionary rule.

The Court addresses the question of unfair prejudice. "Evidence is prejudicial under Rule 403 if it involves some adverse effect . . . beyond tending to prove the fact or issue that justified its admission into evidence." Highland Capital Mgmt., L.P. v. Schneider, 551 F. Supp. 2d 173, 176- 77 (S.D.N.Y. 2008). The Court has weighed the potential prejudicial effect of the introduction of this evidence as well as the other potential consequences of this evidence under Rule 403, including the possibility of wasting time, confusing the jury, and the like. Defendants have argued that introducing this evidence threatens to prejudice the defendants in those ways. Because this evidence can confuse the jury and lead them to consider defendants' conduct in the matters that were the subject of the customer complaints rather than focusing on the matters at issue here. The Court further recognizes the concern that allowing plaintiff to introduce this evidence could create "the classic trial within a trial that Rule 403 seeks to prevent" by causing the jury to consider facts and claims foreign to the instant matter. Hart v. RCI Hosp. Holdings, Inc., 90 F. Supp. 3d 250, 280 (S.D.N.Y. 2015).

I am going to turn now and ask plaintiff's counsel to pick up their phone, briefly, because I would like to ask briefly about how it is that you anticipate that you would introduce this evidence in order to avoid the kind of concerns that are articulated by the defendants, which is that this would become a case about all of the underlying facts described in the list of complaints. What can you tell me about your expectations regarding the scope of that evidence and the means by which you would introduce it?
counsel?

MR. STOELTING: Your Honor, there are a couple of possibilities. One would simply be a stipulation with defendant because there is no dispute about the existence of these complaints and that they were all resolved and what the complaints were, they're all disclosed on the publicly-available broker check report. And so, it could either be a stipulation or it could simply be showing the defendant a list of the complaints and saying these were all complaints asserted against you at the time or before and having the defendant agree that way. But, you know, we would intend to do it in a way that would be expeditious and would not consume a lot of court time because, as we had argued in the papers, it is really to show their knowledge that the same strategy they were pursuing with the customers at issue they were pursuing in other accounts and it was generating nearly a dozen complaints, and they obviously knew about these complaints at the time they were recommending the same exact strategy to other customers.

THE COURT: Good. Thank you very much.

So, counsel, I appreciate that. Given that proffer, I'm going to permit the inter duction of this evidence. I believe that it is highly probative of defendants' scienter. While I recognize the risk that prejudice and of confusing the jury and wasting time is argued by defendants, I don't believe that it outweighs the substantial probative value of this evidence. Moreover, I invite defendants to present a proposed limiting instruction with respect to this evidence. Such a limiting instruction might focus the jurors on the fact that this evidence is accepted for a limited purpose only, particularly, when coupled with a proper limiting instruction, which I expect defendants will propose. I do not believe that this evidence should be excluded categorically.

My hope, counsel for plaintiff, is that consistent with your description now, your presentation of this information will be relatively straightforward consisting, in essence of the provision of the report itself to the jury. To the extent that defendants want to make this a trial within a trial in order to impeach that evidence, I expect that I would give them some latitude to do so. But, consistent with plaintiff's description of how they intend to use this document, I do not expect to permit plaintiffs to introduce substantial independent evidence regarding the underlying facts of each of these complaints here, that such a process will be inefficient and waste the jury's time. In any event, it is not what the SEC proposes to do.

So, while the Court will allow plaintiff to introduce this evidence, it expects that it will issue a limiting instruction to the jury directing them only to consider the customer complaints for proper purposes consistent with a proposed limiting instruction that I expect defendants will propose.

For those reasons, defendants' motion to preclude evidence concerning other customer disputes, including lawsuits and arbitrations, is denied. As suggested by counsel for plaintiffs' comments now, I too, note, that some of the customer disputes seem to post-date the claims at issue here. To the extent that they do, they are irrelevant to the question of defendants' scienter with respect to their conduct for these accounts. And, to the extent that they are relevant, their relevance is substantially outweighed by the potential to confuse the jury. As a result, any such customer complaints or other matters post-dating the events at issue in this case should be excluded and redacted from necessary from the report of the complaints.

Let me turn to defendants' motion to exclude evidence related to unauthorized trades, unsuitability, and churning.

First, unauthorized trades. Excluding evidence of unauthorized trading for customers not identified in the amended complaint.

Defendants seek to exclude evidence that the SEC may seek to introduce regarding unauthorized trading. First, defendants argue that the SEC can only introduce evidence of unauthorized trading in relation to four customers: Bernardo, Deuschle,Estrada and Pilkington. Defendants present two arguments in support of this argument. First, defendants claim that plaintiff's amended complaint "only alleged unauthorized trading claims with regard to seven customers" and, therefore, defendants contend that "the SEC should be precluded from proffering any evidence of alleged unauthorized trades with regard to"other customer accounts. Docket no. 103-1 at 7.

As an initial matter, Defendants appear to misread the Amended Complaint. The Amended Complaint identifies the seven customers that Defendants reference as "selected examples of unauthorized trades," but alleges that Defendants executed unauthorized trades in 27 customer accounts. See, e.g., Dkt. No. 25 at 18, 37. Furthermore, the Court may "accept any and all evidence that plaintiff can adduce in support of its claim." Sabella v. Scantek Med., Inc., No. 08 CIV. 453 CM HBP, 2010 WL 4537754, at *1 (S.D.N.Y. Nov. 8, 2010). And a party can amend a complaint to conform to the evidence presented at trial, even after the entry of judgment. See Hernandez v. Goord, No. 01-CV-9585 SHS, 2014 WL 4058662, at *3 (S.D.N.Y. Aug. 14, 2014).

There is no question that the defendants were on notice of the SEC's allegations or claims with respect to the additional customers and as a result, the Court will not limit the evidence of trading to these four accounts alone.

2. Excluding the summary evidence of telephone records.

Defendants also ask the Court to exclude charts summarizing the phone records associated with phone numbers that the SEC obtained pursuant to subpoenas issued to JD Nicholas' phone providers.

Federal Rule of Evidence 1006 provides: "The proponent may use a summary, chart, or calculation to prove the content of voluminous writings, recordings, or photographs that cannot be conveniently examined in court." Rule 1006 further states that, "[t]he proponent must make the originals or duplicates available for examination or copying, or both, by other parties at a reasonable time and place. And the court may order the proponent to produce them in court." Summary evidence must "be based on foundation testimony connecting it with the underlying evidence summarized" and must be "based upon and fairly represent competent evidence already before the jury." Fagiola v. Nat'l Gypsum Co. AC & S., 906 F.2d 53, 57 (2d Cir. 1990) (internal citations omitted).

Counsel for defendants, I would like to ask you to take your phone off mute for just a moment. I would like to ask you two brief questions.

First, based on the representations in your declaration from April 1, 2019, which is a docket no. 103, Exhibit 3, I understand that the SEC has made all of the underlying telephone records available; is that correct?

MR. O'BRIEN: That is correct.

THE COURT: Thank you.

Counsel for defendants, can I ask, there are a number of purported summary exhibits which I understand the SEC plans to introduce under Federal Rule of Evidence 1006. Do you object to them on any basis other than the argument that the underlying records are incomplete?

MR. O'BRIEN: Yes. We object on the grounds of completeness and foundation.

THE COURT: Thank you. And both relating to the nature of the underlying records; is that correct?

MR. O'BRIEN: I'm sorry, your Honor? Say that again, please?

THE COURT: Yes; both relating to the nature of the underlying records; is that correct?

MR. O'BRIEN: That's correct, your Honor.

THE COURT: Thank you. Good. I think I want to talk briefly about the summary exhibits despite the fact that defendant has not objected to them on another basis but I want to raise an issue for the parties to consider.

Thank you, counsel for defendants. You can place your phone on mute again.

So, defendants seek to exclude this evidence because, as just asserted, they claim that the phone records are incomplete. See docket no. 103-1 at 7-12. As such, defendants argue that allowing the SEC to introduce the phone records would result in unfair prejudice that outweighs probative value that the evidence offers, and also they argue that the evidence is incomplete and should not go to the jury at all. However, the completeness of this evidence goes to the weight that the jury gives the evidence, not to the question of admissibility.

See, e.g., BD ex rel Jean Doe DeBuono, 193 F.R.D. 117, 132 (S.D.N.Y. 2000) (denying plaintiff's motion in limine seeking to exclude records that were allegedly incomplete on grounds that the undue prejudice that introducing this evidence would cause outweighed its probative value); see also Wilbur v. City of Mount Vernon, No. 11 Civ. 1100 (RSL), 2013 WL 1774624, at *1 (W.D. Wash. Apr. 25, 2013) (explaining that whether evidence is completely accurate "goes to the weight of the evidence, not its admissibility"). This proposition is equally true for summary evidence admitted under Rule 1006. See U.S. ex rel. Evergreen Pipeline Constr. Co. v. Merritt Meridian Constr. Corp., 95 F.3d 153, 163 (2d Cir. 1996) (explaining that objections that a summary "d[oes] not fairly represent the [underlying] documents and [is] excessively confusing and misleading go more to [the summary's] weight than to its admissibility.")

In any event, the fact or the alleged allegation that these records are incomplete as presented by defendants is insufficient justification for the Court to exclude the records entirely or to prevent the plaintiffs from providing appropriate summary exhibits to the jury under Rule 1006. With respect to the foundational issue that has just been raised by counsel and has been raised by counsel as we discussed indicatively during our final pretrial conference, I anticipate that counsel will have the opportunity to question, as necessary, the person who is offering these records and will take the opportunity as they deem fit to point out any asserted gaps in these records for the jury's consideration.

Accordingly, defendants' motion to limit plaintiff to introducing evidence of unauthorized trades with respect to the seven customers that it has identified in the amended complaint and to preclude plaintiff from introducing the summary charts with respect to those records under Rule 1006, is denied.

I want to pause briefly on the summary charts that have been presented. Counsel for defendants has not asserted an objection to those charts on any basis other than the completeness and foundational issues that we have just discussed and I understand that that's the case. I have looked at some of the exhibits and I would ask the parties to look at whether each of those exhibits fits within the scope of the rule, i.e., that it is a summary of voluminous underlying documents as opposed to being, I will call it, a demonstrative extrapolating data from underlying documents. I'm not taking a position on that issue because it has not been raised by the parties, but I want to raise it on my own now and ask the parties to look at those exhibits and to ensure that you both believe that they are appropriate summary exhibits within the scope of the rule and that therefore they can come in as direct evidence, as opposed to being something like a demonstrative that provides a party's views regarding the meaning of the records rather than summarizing them and I will ask you to look at the records, the exhibits to let me know your view about that. I'm going to ask that you write me by early next week, if you believe that there are supplemental concerns regarding the proposed exhibits which have been described by plaintiffs' counsel as 1006 summaries.

Unsuitability.

Defendants next ask the Court to "preclude the SEC from offering evidence of unsuitability with respect to any customer that does not testify at trial." Dkt. No 103-1 at 13. Defendants argue that the Court should exclude this evidence because "[w]ithout that testimony, it will be impossible for the SEC to establish what material misrepresentations or omissions were made/omitted or which specific transactions were not suited to the customer's needs." Id. at 14. The Court declines to exclude the evidence of unsuitability on these grounds because "[g]enerally, on a motion in limine, the question of admissibility, not sufficiency, is the issue for the Court." Capitol Records, Inc. v. MP3tunes, LLC, No. 07 CIV. 9931 WHP, 2014 WL 503959, at *5 (S.D.N.Y. Jan. 29, 2014); see also Bowers v. Nat'l Collegiate Athletic Ass'n, 563 F. Supp. 2d 508, 532 (D.N.J. 2008) ("It is well settled that motions in limine address evidentiary questions and are inappropriate devices for resolving substantive issues, such as the sufficiency of the evidence to support a claim or defense."); C & E Servs., Inc. v. Ashland Inc., 539 F. Supp. 2d 316, 323 (D.D.C. 2008) ("a motion in limine should not be used to resolve factual disputes or weigh evidence.")

Accordingly, whether the SEC will be able to put forth sufficient evidence to satisfy its burden with respect to the customers who are not testifying at trial does not present adequate grounds to preclude the SEC from introducing evidence of unsuitability with respect to these customers. Therefore, Defendants' motion to preclude evidence of unsuitability with respect to any customer that does not testify at trial is denied.

Pardon me. Give me one moment, please?

(pause)

THE COURT: Counsel?

MR. STOELTING: Yes, your Honor. Plaintiff is here.

MR. O'BRIEN: And defendants are here.

THE COURT: Good. I'm sorry about that, counsel. I put you on mute briefly. You can place your phones back on mute. I apologize for the brief interruption.

Churning.

Defendants next ask the Court to preclude the SEC from offering data demonstrating annual turnover, cost-to-equity, average equity, and other evidence related to churning because the SEC has indicated that it no longer seeks to pursue its claims related to churning. Docket no. 103-1 at 13.

Defendants seek to exclude this evidence under Rule 403. They do not argue that this evidence is not relevant, although they do to some degree because they argue that the claim is not in. They also contend that the risk of unfair prejudice outweighs any probative value because the claims are no longer before the Court.

Now, defendants' argument with respect to this issue rested on their errant belief that any evidence of excessive trading turns the SEC's remaining claims into a churning or quantitative suitability claim. I will address that argument at length momentarily. For now, let me say that this evidence is relevant both to the dismissed churning claim and the continuing claims. As the Court explained at summary judgment, the evidence of unreasonable turnover and high cost equity ratios are highly relevant to the claims that remain at issue in this case, not only the churning claims. See docket no. 95 at 12. Additionally, contrary to defendants' arguments, many districts in enforcement cases have declined to preclude the SEC from introducing evidence supporting dismissed claims that is also relevant to remaining claims. See, e.g., Dollman v. Mast Industries, Inc., No. 08 Civ. 10184 (WHP), 2011 WL 3911035 at *5 (S.D.N.Y. Sept. 6, 2011); Sec. & Exch. Comm'n v. Goldstone, No. CIV 12-0257 JB/GBW, 2016 WL 3625405, at *14 (D.N.M. June 13, 2016).

Defendants' motion seeking to preclude plaintiff from introducing all evidence of excessive trading in the accounts is denied.

The Court now turns to address plaintiff's motion *in limine* and, as I just said, a substantial portion of the rationale for my decision with respect to that immediately prior motion will be embedded in my decision with respect to plaintiffs' motion.

The Securities and Exchange Commission's omnibus motion *in limine* to exclude evidence or argument about victim sophistication and evidence or argument about post-investment risk disclosures.

Plaintiff argues that three categories of evidence are inadmissible. I will describe those broadly as evidence of customer sophistication, post-investment risk disclosures, and communications within the SEC. Below, the Court addresses these three categories of evidence that plaintiff seeks to exclude.

Evidence of "customer sophistication."

The SEC seeks to preclude defendants from introducing three categories of evidence that purportedly touch on the customers' alleged visit indication. These classes of evidence are (1) brokerage accounts that the customers held outside the defendants' firm; (2) other brokerage accounts that the customers had with the defendants' firm; and (3) the customers' tax returns.

I want to address the most significant issue here first which is that defendants seek to transmogrify the SEC's reasonable basis suitability claim into a claim alleging that the defendants violated their quantitative suitability obligations simply because the SEC alleges that defendants' trading strategy was unsuitable, in part, because of the high frequency of the trades. Because defendants assert that the SEC advances a quantitative suitability claim masked as a reasonable basis suitability claim, they contend that the evidence of customer sophistication is highly relevant to the issue of control -- which a plaintiff must demonstrate to state a claim that a party breached his quantitative suitability obligations. See Docket no. 115 at 8. Defendants' argument finds no support in FINRA guidance or the Circuit's precedent.

As I described at the outset, the three categories of suitability claims are separate, and independent. There is no basis in the text of the rule to conclude that, as Defendants argue, any quantitative issue with a broker's proposed strategy must be pursued only as a quantitative suitability claim, rather than forming the basis for one of the other categories of claims. Defendants' position is also not supported by applicable precedent. In the Matter of the Application of Pinchas, the Commission affirmed the National Association of Securities Dealers' findings that Pinchas engaged in excessive trading and made unsuitable recommendations. In Pinchas, the commission analyzed questions of excessive trading and unsuitable recommendations separately. In its discussion of Pinchas' unsuitable recommendations, the Commission concluded that Pinchas' trading strategy was unsuitable for the customers in light of the "level and type of trading" the trading strategy's "aggressive" nature, and Pinchas' use of "in-and-out" trading. In the Matter of Pinchas, at *8. Ten years later, in Medeck, a FINRA hearing panel made clear that quantitative suitability is "doctrinally distinct from the other two suitability theories" and that it requires "elements of proof that are not necessary under the other theories." See IN THE MATTER OF DEPARTMENT OF ENFORCEMENT, COMPLAINANT KEITH HOWARD MEDECK, RESPONDENT, 2009 WL 2424489, at *10. Pinchas and Medeck, therefore, undermine Defendants' argument that any time a plaintiff sues a broker for failing to have a reasonable basis to recommend a pattern of trading that may involve in and out or high frequency trading, then the plaintiff must bring that claim as a churning claim and must prove control.

Second Circuit precedent is also instructive. In Hanly v. SEC, the Second Circuit explained that a broker "cannot recommend a security unless there is an adequate and reasonable basis for such recommendation" and further made clear that "the fact that his customers may be sophisticated and knowledgeable does not warrant a less stringent standard." 415 F.2d 589, 595 (2d Cir. 1969). Whether a broker controlled an account requires a court to consider, among other factors, the age, education, intelligence, and business experience of the client. See, e.g., Zaretsky v. E. F. Hutton & Co., 509 F. Supp. 68, 74 (S.D.N.Y. 1981). The evidence of customer sophistication at issue here goes to whether defendants exercised control or de facto control over the accounts of their customers. However, as made clear in *Hanly*, the question of control, I should say, however, is made clear in the applicable precedent. The question of control is not relevant to the SEC's claim that defendants violated their reasonable basis suitability obligation.

Defendants' argument that any reasonable basis or customer specific suitability claim that involves an element of excessive trading must be pursued as a "quantitative suitability" or "churning" claim has no basis in the law. Adopting their position would mean that a broker without control or de facto control of his customers' accounts could recommend an absolutely insane high frequency trading strategy without facing the prospect of liability. I understand the appeal of the argument to defendants here but the argument is profoundly flawed and lacks foundation in the law.

Because defendants' argument that this case must be pursued as a "churning claim" is wrong, there is no relevance to the evidence related to the defendants' control or de facto control over the accounts. To the extent that it has any relevance, it is outweighed by the prejudicial nature of the evidence, which will distract the jury from the fundamental issues involved in the case. The Court therefore concludes that this evidence has little, if any, probative value with respect to the SEC's reasonable basis suitability claim.

The evidence also has little, if any, probative value to the SEC's customer-specific suitability claim. As explained previously, customer-specific suitability requires a broker to "have a reasonable basis to believe that the recommendation is suitable for a particular customer based on the customer's investment profile," which includes "the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the broker to the" broker. FINRA Rule 2111(a). This evidence could perhaps have been relevant to the customer's specific claim if the customers had disclosed it to defendants. However, it is undisputed that defendants neither read nor considered the documents in question when making their trading recommendations, or conducting their supposed due diligence. In this context, evidence that defendants never saw, read, or consulted is not relevant and to the extent that it has any relevance on the issues being litigated here is very small and is dramatically outweighed by the risk of prejudice and confusion.

The Court finds that allowing defendants to introduce this evidence presents a risk of unfairly prejudicing the SEC, confusing the jurors in particular regarding the issues in this case, and wasting time. The evidence at issue spans thousands of pages. This evidence, which involves tax records and descriptions and logs of trades executed with other brokerage firms and other accounts with defendants' firm, could potentially mislead jurors by encouraging them to focus on facts and transactions not relevant to the accounts and claims at issue in this case. What's more, if defendants introduce this evidence, defense counsel would likely have to provide lengthy exposition for each record for the jury. This would undoubtedly lengthen the trial and run substantial risk of wasting time.

Here, because the risk of unfair prejudice confusing the issues, misleading the jury, and wasting time substantially outweighs this proposed evidence's probative value, the SEC's motion to preclude evidence of supposed customer sophistication is granted. However, I accept from this ruling, of course, the defendants' ability to use this evidence for the limited purpose of impeaching a witness' testimony as, and to the extent, appropriate. See FRE 613.

Post-investment risk disclosures, the account letters.

The SEC also seeks to exclude four categories of documents that defendants' employers sent to customers after the customers had opened their accounts. These documents include: I) intent to maintain account letters; ii) day trading risk disclosures; iii) account activity letters; and iv) trade confirmations (collectively, the "Account Letters"). The SEC argues that the Court should preclude Defendants from introducing the Account Letters because any probative value that their disclaimers offer is substantially outweighed by unfair prejudice and other factors outlined in Rule 403. The Court disagrees.

In this case, the SEC asserts fraudulent omission claims against Defendants under Rule 10b-5 of the Exchange Act and Section 17(a)(2) of the Securities Act. The SEC alleges that Defendants' material omission was "their fail[ure] to disclose that they had no reasonable basis to believe that their . . . strategy would have any likelihood of generating profits." Dkt. No. 109 at 21.

I find that the risk disclosures included in the account letters and other information contained therein is relevant to the issue of whether defendants' customers were aware of the likelihood that defendants' trading strategy would not generate meaningful profits. At the outset, the SEC has not pointed me to any case law that supports their apparent position or its apparent position that, in essence, only disclosures that specifically state their formulation of the missing information is relevant. The SEC has argued that the disclosures are boiler plate and there therefore they do not provide adequate disclosure as a matter of law.

Unlike the cases cited to by the SEC in support of their position, however, this case is not about disclosure in the context of a required securities filing such as a 10-k. The information provided to the customers in these disclosures is part of the mix of information that the brokers and their firm made available to them. Even if one piece of this disclosure might be inadequate on its own to provide full disclosure, the information provided in them, based on the information provided in them, a reasonable jury could find that in conjunction with other information that the defendants may have provided orally or in writing, that this information provided adequate disclosure to the customers. The day trading risk disclosure statement informs customers that "day trading can be very risky" and advises them that they "should be prepared to lose all of the funds that [they] use for day trading." Docket no. 108, Exhibit L at 2. The day trading risk disclosure statement also explained that "day trading will generate substantial commissions" and that the "commissions... will add to... losses or significantly reduce... earnings." Id. similarly, the account activity letters warn customers that "actively trading on a short-term basis" -- as is the nature of the day trading -- "can be costly." Id., Ex. M. The trade confirmation statements allowed customers to see the cost of their trades by listing the commission Defendants' employer received from each trade. Id., Ex. N. Finally, by signing the intent to maintain account letters, the customers affirmed that they were "completely aware of the risks involved with the trading strategy that [they] adopted." Id., Ex. L. I decline to excise any element, particular element of the disclosures provided by the brokers or their firms to the customers because the SEC argues that that particular disclosure, on its own, was insufficient.

The risk of confusing the jury or other prejudice does not outweigh the probative value of this evidence. The SEC principally argues on this point that allowing defendants to introduce this evidence would result in confusing the jury or other prejudice because the volume of these records will "swamp" the jury.

While the volume of this evidence may be significant, I don't believe there to be significant variation among the documents in each of the relevant categories. As a result, while I understand the defendants may wish to introduce a significant volume of documents in the aggregate, I don't expect that we will need to use a lot of in-court time to discuss them.

Counsel for defendants, let me ask you to take your phone off mute for me to ask, you have a question about these records during the trial.

So, Mr. O'Brien, is it fair, counsel, that you do not expect to spend a lot of in-court time using these records and can you tell me something about how it is that you would expect to use them?

MR. O'BRIEN: Yes, your Honor.

To the extent that particular customers executed or signed one disclosure or another, it would be our intention to get them to acknowledge that they signed the disclosure and then point them to a few items in those disclosures that might be relevant to their understanding of the risks associated with trading strategy and the costs associated with that trading strategy.

THE COURT: Thank you.

You are not planning to walk through each and every trade confirmation; is that right?

MR. O'BRIEN: That is correct. We would not be going through every trade confirmation. We might elect a handful of confirmations for some customers and for other customers we may not review any of them.

THE COURT: Thank you. Fine.

So, that's consistent with my expectation regarding how you would use it. As a result, I'm not concerned that this evidence will swamp the jury. While they may have a volume of it in the jury room I, as I said earlier, understand that many of the form disclosures are similar and defendants' proposed use of them, I believe, is prudent and not unduly wasteful of the jury's time.

So, because the Court has found this evidence is relevant and that the risk of misleading, confusing the jury and wasting time and does not substantially outweigh the probative value of the evidence, I am denying plaintiff's motion to exclude the account letters.

SEC communications.

Finally, the SEC seeks to preclude Defendants from introducing evidence of communications between SEC attorneys, the SEC's summary witness, and Defendants' counsel regarding the telephone records. Dkt. No. 109 at 19-20. Defendants seek to introduce this evidence to "establish[] that the SEC was aware that the telephone records were incomplete when it performed its analysis of those records." Dkt. No. 115 at 24. However, what the SEC believed or communicated about the telephone records, as captured in the evidence that Defendants seek to introduce and the SEC seeks to exclude, is not probative of the issue motivating Defendants to introduce this evidence, namely the completeness of the records it is, I will call it, ancillary evidence of the completeness of the records, any probative value of this particular evidence, I believe, is minor. On the other hand, allowing defendants to introduce evidence regarding communications amongst the SEC team runs a substantial risk of confusing the jury and prejudicing the SEC.

The SEC would be prejudiced by this evidence because it would, in the words of another Court, "shift the focus away from the relevant evidence... to the tangentially related [acts] of one government agent." United States v. Malpeso, 115 F.3d 155, 163 (2d Cir. 1997). Accordingly, Plaintiff's motion to exclude these communications between, amongst the SEC employees and their teammates, is granted.

Now, one caveat with respect to this, namely, that I do not expect to limit defendants from questioning the SEC summary witness about the underlying records and his or her view with respect to them. What I am avoiding by granting this motion is the insertion into the trial of the examinations of the internal communications within the legal team on one side of the V which I don't think is appropriate. If the SEC puts a witness on the stand, however, with respect to the underlying documents, I am not at this time seeking to limit the testimony of that witness regarding his or her views or knowledge related to the underlying records as part of the authentication of the charts or summary evidence that the SEC seeks to bring in.

So, in conclusion, for the reasons that I have stated, defendants' motion to exclude the testimony of Eugene Bernardo, Docket no. 101, is denied.

Defendants' motion to exclude evidence concerning other customer disputes, Docket no. 102, is denied.

Defendants' motion to exclude evidence related to unauthorized trades, unsuitability, and churning, Docket no. 103, is denied.

Plaintiff's motion to exclude evidence and arguments regarding customer sophistication, post-investment disclosures, and SEC communications, Docket no. 107, is granted in part and denied in part. The motion is granted with respect to evidence of customer sophistication and the SEC communications. It is denied with respect to the post-investment disclosures.

So, thank you very much, counsel. For bearing with me. I am going to propose that we take a short, five-minute recess, and I will put you on mute briefly and then I will confirm that you are back on the line when we recommence with the Daubert.

Thank you.

(recess)

THE COURT: I'm sorry, counsel. Is counsel for plaintiff there?

MR. STOELTING: Yes, your Honor.

THE COURT: Good. Thank you.

Counsel for defendants?

MR. O'BRIEN: We are, your Honor.

THE COURT: Good. Thank you very much. Let me ask you to place your phones back on mute. I'm now going to take some time to work through the Daubert motion.

As you know, plaintiff has filed a motion to exclude the defendants' expert witness, Mr. Conner, under Rule 702 of the Federal Rule of Evidence and Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993). I am going to grant in part and deny in part plaintiff's motion to exclude the testimony of Mr. Conner. I will now explain why.

Legal standard. Daubert standard generally.

In Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993), the Supreme Court explained that Rule 702 requires district courts to act as gatekeepers by ensuring that expert scientific testimony "both rests on a reliable foundation and is relevant to the task at hand." Id. at 597. As such, the Court must make "a preliminary assessment of whether the reasoning or methodology underlying the testimony is scientifically valid and of whether that reasoning or methodology properly can be applied to the facts in issue." Id. at 592-93. In short, the Court must "make certain that an expert, whether basing testimony upon professional studies or personal experience, employs in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field." In Kumho Tire Co. v. Carmichael, 526 U.S. 137, 152 (1999), the Supreme Court held that a district court's gate keeping function applies to all expert testimony, whether based on scientific, technical or other specialized knowledge. Id.

Daubert set forth a non-exhaustive list of factors that district courts may consider in gauging the reliability of scientific testimony, which include: (1) whether the theory has been tested; (2) whether the theory has been subjected to peer review and publication; (3) the known or potential rate of error and whether standards and controls exist and have been maintained with respect to the technique; and (4) the general acceptance of the methodology in the scientific community. Daubert, 509 U.S. at 593-95. "Whether some or all of these factors apply in a particular case depends on the facts, the expert's particular expertise, and the subject of his testimony." In re Fosamax Products Liab. Litig., 645 F. Supp. 2d 164, 173 (S.D.N.Y. 2009) (citing Kumho Tire, 526 U.S. at 138).

"In undertaking this flexible inquiry, the district court must focus on the principles and methodology employed by the expert, without regard to the conclusions the expert has reached or the district court's belief as to the correctness of those conclusions." Amorgianos v. Nat'l R.R. Passenger Corp., 303 F.3d 256, 266 (2d Cir. 2002). But as the Supreme Court has explained, "conclusions and methodology are not entirely distinct from one another," and a district court is not required to "admit opinion evidence that is connected to existing data only by the ipse dixit of the expert. A court may conclude that there is simply too great an analytical gap between the data and the opinion proffered." Gen. Elec. Co. v.

Joiner, 522 U.S. 136, 146 (1997). "Thus, when an expert opinion is based on data, a methodology, or studies that are simply inadequate to support the conclusions reached, Daubert and Rule 702 mandate the exclusion of that unreliable opinion testimony." Amorgianos, 303 F.3d at 266.

To warrant admissibility, "it is critical that an expert's analysis be reliable at every step." Id. at 267. "In deciding whether a step in an expert's analysis is unreliable, the district court should undertake a rigorous examination of the facts on which the expert relies, the method by which the expert draws an opinion from those facts, and how the expert applies the facts and methods to the case at hand." Id. Nevertheless, evidence should only be excluded "if the flaw is large enough that the expert lacks good grounds for his or her conclusions." Id. (internal quotation marks and citation omitted)).

"In fulfilling its gatekeeping role, the Court "should look to the standards of Rule 401 in analyzing whether proffered expert testimony is relevant . . . ." Id. at 265. "Weighing whether the expert testimony assists the trier of fact goes primarily to relevance." Faulkner v. Arista Records LLC, 46 F. Supp. 3d 365, 375 (S.D.N.Y. 2014) (citing Daubert, 509 U.S. at 591). Expert testimony that is "directed solely to lay matters which a jury is capable of understanding and deciding without the expert's help" should not be admitted.

United States v. Mulder, 273 F.3d 91, 101 (2d Cir. 2001) (quoting United States v. Castillo, 924 F.2d 1227, 1232 (2d Cir. 1991)). In addition, "expert testimony, like all evidence, is also subject to the requirements of Rule 403, which provides that otherwise relevant evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury. In re Puda Coal Sec. Inc., Litig., 30 F. Supp. 3d 230, 250 (S.D.N.Y. 2014) (internal quotation marks omitted) (quoting Nimely v. City of New York, 414 F.3d 381, 396 (2d Cir. 2005)). Importantly, "the proponent of expert testimony has the burden of establishing by a preponderance of the evidence that the admissibility requirements of Rule 702 are satisfied." United States v. Williams, 506 F.3d 151, 160 (2d Cir. 2007).

Rule 26(a) 2B's disclosure requirements.

Fed.R.Civ.P. 26(a)(2) governs expert disclosures. Rule 26(a)(2)(B) requires an expert witness to provide a written report "if the [expert] witness is one retained or specially employed to provide expert testimony in the case or one whose duties as the party's employee regularly involve giving expert testimony." The written report must include, inter alia, "a complete statement of all opinions the witness will express and the basis and reasons for them; the facts or data considered by the witness in forming them; [and] any exhibits that will be used to summarize or support them." Rule 26(a)(2)(B)(i)-(iii). As explained in the Advisory Committee notes, Rule 26(a) "requires that persons retained or specially employed to provide expert testimony ... must prepare a detailed and complete written report, stating the testimony the witness is expected to present during direct examination, together with the reasons therefor." Rule 26(a)(2)(B) Advisory Committee Notes on 1993 amend. (2)(B). "The purpose of the rule is to prevent the practice of 'sandbagging' an opposing party with new evidence." Ebewo v. Martinez, 309 F.Supp.2d 600, 607 (S.D.N.Y.2004)(citations omitted). To that same end, Rule 26 also imposes a continuing obligation on parties to supplement or correct expert disclosures "in a timely manner." Rule 26(e)(1)(A).

Pursuant to Rule 37(c)(1), a party who fails to provide information required under Rule 26(a) or (e), "is not allowed to use that information . . . to supply evidence on a motion, at a hearing, or at a trial, unless the failure was substantially justified or is harmless". Like Rule 16(f), Rule 37(c)(1)(C) permits the court to impose any other sanction it deems appropriate, including those listed in Rule 37(b)(2)(A)(i)-(vi). Although there is language in the Advisory Committee Notes to the 1993 amendments to Rule 37 suggesting that preclusion is intended as an "automatic sanction" for untimely disclosures, the Court of Appeals for the Second Circuit has explained that the structure of the Rule does not warrant this interpretation and has directed district courts to use a more flexible approach in assessing the consequences of a party's untimely disclosure or amendment of a disclosure previously made. Design Strategy, Inc. v. Davis, 469 F.3d 284, 296-98 (2d Cir. 2006). Specifically, the Court of Appeals has identified four factors to be considered in determining whether an order of preclusion is appropriate:

(1) the party's explanation for the failure to comply with the [disclosure requirement]; (2) the importance of the testimony of the precluded witness [es]; (3) the prejudice suffered by the opposing party as a result of having to prepare to meet the new testimony; and (4) the possibility of a continuance.

Patterson v. Balsamico, 440 F.3d 104, 117 (2d Cir. 2006) (alterations in original), citing Softel, Inc. v. Dragon Med. & Scientific Commc'ns, Inc., 118 F.3d 955, 961 (2d Cir.1997). A finding of bad faith, however, is not required before sanctions can be imposed under Fed.R.Civ.P. 37(c)(1). Design Strategy, Inc. v. Davis, 469 F.3d at 296.

"[T]o the extent that an expert affidavit is within the scope of the initial expert report, it is properly submitted in conjunction with dispositive motions even outside the time frame for expert discovery." Cedar Petrochemicals, Inc. v. Dongbu Hannong Chem. Co., 769 F.Supp.2d 269, 279

(S.D.N.Y.2011) (Francis, M.J.) (citations omitted). However, "[e]xpert testimony exceeding the bounds of the expert's report is excludable pursuant to Rule 37(c)(1)." In re Kreta Shipping, S.A., 181 F.R.D. 273, 275 (S.D.N.Y.1998); see also Rowe Entm't, Inc. v. William Morris Agency, Inc., 98-CV-8272 (RPP), 2003 U.S. Dist. LEXIS 17623, at *5 n. 3, 2003 WL 22272587 [at *1 n. 3] (S.D.N.Y. Oct. 2, 2003). The "duty to disclose information concerning expert testimony is intended to allow opposing parties to have a reasonable opportunity [to] prepare for effective cross examination and, perhaps, arrange for expert testimony from other witnesses." LaMarca v. United States, 31 F.Supp.2d 110, 122 (E.D.N.Y.1999) (citation and internal quotation marks omitted). Thus, "courts will not admit supplemental expert evidence following the close of discovery when it 'expound[s] a wholly new and complex approach designed to fill a significant and logical gap in the first report,' as doing so 'would eviscerate the purpose of the expert disclosure rules.' " Cedar Petrochemicals, Inc. v. Dongbu Hannong Chem. Co., 769 F.Supp.2d 269, 279 (S.D.N.Y.2011) [(Francis, M.J.)] (quoting United States v. City of N.Y., 637 F.Supp.2d 77, 107 (E.D.N.Y.2009));

Discussion. First, let me address the issue of Mr. Conner's supplemental declaration. Mr. Conner has offered a number of additional justifications for his opinions and the extensive declaration presented in connection with the opposition to the motion. That declaration reads very much like a supplemental expert report, as counsel for the SEC has observed. There is no sufficient justification for substantial modifications of Mr. Conner's report. A supplemental disclosure came off the close of discovery and, as a result, the plaintiff did not have an opportunity to evaluate it and any modified opinions contained in it.

I want to note in particular that Mr. Conner's report, the underlying report does not describe an opinion with respect to the issue of either customer-specific or reasonable basis suitability. His opinion is limited to "the churning" claim that the SEC is no longer pursuing. Mr. Conner, accordingly, may not testify regarding his opinion with respect to whether the brokers' trading strategy satisfied their obligations under either of the claims that the SEC is in fact pursuing here. Again, I note that the SEC has removed its churning claim but has always been pursuing the other two bases for its claims here. Therefore, defendants' expert had the opportunity to offer expert testimony on those issues from the outset. There is no good cause or substantial justification for the failure to proffer such testimony at an earlier stage of the case. Defendants have not sought leave to amend their expert disclosure to include such testimony. But, in any event, it would not be warranted here. As you know, we are nearing the eve of trial and there would be no opportunity for the SEC in advance of trial, to plumb Mr. Conner's views with respect to the issues that are in the case, that is other than quantitative suitability, in advance of trial.

So, testimony that Mr. Conner might offer regarding the brokers' satisfaction of their obligations with respect to the remaining suitability claims, to be very clear, should be, and is, excluded.

That said, just to establish a baseline, I want to say that I am considering Mr. Conner's declaration for the limited purpose of evaluating the motion to exclude his testimony, particularly insofar as it relates to the basis for the methodology that he applied to calculate cost equity and turnover in the selected accounts. That information is not so wholly new and complex and the plaintiff had the opportunity to question Mr. Conner about the methodology that he employed in his calculations during his depositions so I am looking to the additional statements in Mr. Conner's declaration in order to evaluate the methodology that he applied in order to arrive at the calculations contained in his spreadsheets and the basis for those calculations.

Mr. Conner's qualifications as an expert are not disputed. "Courts within the Second Circuit 'have liberally construed expert qualification requirements' when determining if a witness can be considered an expert." Cary Oil Co., Inc. v. MG Refining & Marketing, Inc., 2003 WL 1878246, at *1

(S.D.N.Y. Apr. 11, 2003) "To determine whether a witness qualifies as an expert, the court must first ascertain whether the proffered expert has the educational background or training in a relevant field." Crown Cork & Seal Co., Inc. Master Retirement Trust v. Credit Suisse First Boston Corp., 2013 WL 978980, at *2 (S.D.N.Y. Mar. 12, 2013) (citation and internal quotation marks omitted). "Any one of the qualities listed in Rule 702-knowledge, skill, experience, training, or education-may be sufficient to qualify a witness as an expert." Id. (citing Tiffany (N.J.) Inc. v. eBay, Inc., 576 F. Supp. 2d 457, 458 (S.D.N.Y. 2007)). I have evaluated Mr. Conner's credentials, and conclude that he is qualified to provide testimony regarding the evaluation of investment portfolios based on his educational record and long history in the industry.

With that, let me turn to the disputed areas of Mr. Conner's proposed testimony from his report. First, as counsel for defendants observed in his April 25, 2019 letter to the Court, a number of the issues disputed by the parties in connection with this motion have already been resolved by the Court in connection with its evaluation of the motions *in limine*. In particular, the Court has rejected the defendants' errant argument that any reasonable basis or customer-specific suitability claim that involves a strategy that allegedly involved excessive trading, must be treated as a quantitative suitability claim. As a result, most aspects of Mr. Conner's testimony regarding the SEC's purported churning claim will be excluded. The first point in his summary of opinions at paragraph 12 on page 3 of his report constitutes the elements or description of the elements of a churning claim. I would not permit Mr. Conner, necessarily, to testify recording the law in any event, but this area of testimony is not helpful for the jury because it relates it a claim that is not being pursued here.

Paragraphs 19 through 24 of his report contains Mr. Conner's view regarding de facto control. That line of testimony will not be permitted. Because establishing control or de facto control are not elements of the claims that the SEC is pursuing, that testimony will not help the jury. To the contrary, it will likely confuse them regarding the issues that remain in the case. As a result, the SEC's motion to exclude that portion of Mr. Conner's anticipated testimony that relates to "control"or "de facto control" is granted.

The second argument made in the SEC's motion with respect to Mr. Conner relates to his evaluation of the trade blotters. They claim simply that he interprets it incorrectly. Defendants believe that he is construing it accurately. I am not going to resolve this factual question in the context of this motion. Both parties agree that the blotter is relevant evidence and a reliable basis upon which to base an evaluation of the defendants' trading strategy. Although there is substantial evidence that seems to support the plaintiff's position, I can't conclude, as a matter of law based on this record, that Mr. Conner's interpretation of the blotter is categorically inaccurate. As a result, I will not exclude Mr. Conner's testimony on the basis that he misinterprets the underlying evidence. I expect that the plaintiff's critique of Mr. Conner's analysis, based in part on his testimony from a person with perhaps closer percipient understanding of the charts, will go to the jury's assessment of the weight to be afforded to his testimony generally.

I am granting the SEC's motion in part and denying it in part insofar as it relates to Mr. Conner's calculation of the equity ratios and turnover. As I described earlier, the "churning" claim is out of this case, so I emphasize that I am not making a decision about what calculations are appropriate to support a churning claim, in particular, whether gross equity is an appropriate measure in evaluating a churning claim. Rather, the issue is what evidence may assist the jury in making an evaluation of reasonable basis or customer-specific suitability. I will permit Mr. Conner to testify about his calculations of equity and turnover for the relevant accounts but in doing so, again, I'm not making a finding regarding the propriety of his method and quantitative suitability matters. I am simply concluding that the calculations that he presents and the methodology for calculating them are sufficiently adequately supported so as to permit their introduction here. He describes his methodology as one that was frequently used in the industry. I know that he fails to provide any relevant texts or treatises in support of his position, but his affirmation in the declaration and that the methodology that he used was common currency in the industry is adequate for me to conclude that his methodology is used by others in the industry.

You don't need to have texts, necessarily, in order to qualify methodology, particularly as here, where I understand him to assert that it is in common use in the industry. The methodology that he uses is relatively straightforward so I believe that the information that he presents in his calculations of cost equity and turnover may be presented to the jury, if defendants wish to do so, on a stand-alone basis understanding, again, that arguments related to the insufficiency of the SEC's proof with respect to the discarded churning claim, will not be permitted because that claim is out of the case.

To the extent that these charts would come in, that would be because, presumably because counsel believes that the data can be used to support a reasonable argument that the brokers had a reasonable basis for their strategy for each of these customers. But, again, Mr. Conner cannot opine that they did or that these charts demonstrate that they did -- I'm sorry Mr. Conner cannot opine that they did or that these charts demonstrate that they did and that's because such testimony is outside of the scope of his report.

So, that is why I say that these charts will be introduced on a stand-alone basis, uncoupled to a purported opinion by Mr. Conner regarding what they say about the defendants' reasonable or customer-specific suitability obligations.

However, there are elements of Mr. Conner's opinion in his report that with respect to these calculations that lack any justification. While I accept that he has used an alternative means of calculating turnover and equity here, and that if he is called to testify he would testify that these are alternative methods that are used in the industry, he has provided no basis for his normative conclusions regarding the asserted "inappropriateness," of the SEC's expert's methodology. For example, in his report Mr. Conner describes the SEC's methodology as a "departure from accepted methodology" and "inappropriate as a methodology to use net equity as a denominator methodology..." Report at 13 to 14. He also described the methodology that he has used the calculating "turnover" as appropriate methodology. Report at 14. But, there is no support in his report for the categorical conclusion that the SEC's methodology is inappropriate or that it departs from accepted methodology. There is no citation in the report to studies, treatises, or other orthodoxy that purportedly supports his normative conclusions regarding the relative value of the methods used by the SEC's expert, much less that it departs from the norm. There is no basis for that.

As to Mr. Conner's opinions regarding the asserted, I will call it inappropriateness, or the departure of the SEC's approach from an accepted methodology, or the inadequacy of the SEC's approach stated so categorically, his position appears to be purely *ipse dixit* of an expert unsupported by any basis other than his say-so.

So, I will permit Mr. Conner to introduce his alternative calculation of cost equity and turnover. He can explain what it shows. He can explain how it differs from the SEC's methodology and why it is that he believes that it is an appropriate means of calculating equity and turnover and how that differs from the SEC's approach. But, he cannot categorically state, as he has purported to do in his report, that the SEC's methodology is unorthodox or inappropriate. There is no support in his report for those opinions even as to the churning claims and certainly not as to the claims that the SEC is actually pursuing here. Nor, again, may Mr. Conner provide testimony to suggest that that's reports show that the brokers had a reasonable basis for their trading strategy or customer-specific reasonable basis. I emphasize, again, that such testimony goes beyond the scope of his noticed testimony and must be excluded.

Finally, let me make clear that the expert report of Mr. Conner and written disclosures by him will not be introduced at trial. This is true of both parties' expert witnesses. To the extent that I permit any of Mr. Conner's testimony, it will be admitted through his oral testimony, together with any exhibits that may be introduced in connection with his testimony, subject to the scope limitations that I have just described.

So, thank you very much, counsel, for your patience as I got through that. I appreciate it and I hope you understand why it is that we were unable to get it done during the course of our conference last week. So, thank you again.

Any questions before we adjourn, first counsel for plaintiff?

MR. TENREIRO: Thank you, your Honor.

Just one point of clarification on the ruling excluding non J. Nicholas brokerage records and the Court also said that those records might be used for impeachment.

THE COURT: Yes.

MR. TENREIRO: Our question is how they would be used. I mean, you can imagine a question --

THE COURT: Let me hypothesize. If there is a question, if a witness testifies that they are incredibly poor and there are tax records that show that they are very rich, I can imagine potentially using such a tax record to impeach them, or if they say they never had any other accounts and there is an account statement for another account with another broker, then I can imagine how it is that these records could be used for impeachment purposes but I expect that they will be used for impeachment purposes with respect to testimony that the witness provides.

MR. TENREIRO: Thank you, your Honor. Thank you, your Honor. That's helpful.

And, we also had some sort of procedural questions about trial management, if Mr. Tenreiro could address those, if your Honor can do that? It shouldn't take too much it time.

THE COURT: Thank you. I would be happy to.

First, counsel for defendants, any questions about the ruling themselves? I should say that thanks to the fortitude of our court reporter, a transcript of this will be available at some point.

So, counsel for defendants?

MR. O'BRIEN: Thank you, your Honor.

On the same issue that was raised by the SEC with respect to impeachment documents, perhaps I guess I am inquiring about some more direct examples. In some of the depositions the SEC has questioned the accuracy of the information contained on the new account forms. I presume it would be appropriate for us to impeach the witnesses if they claim that some of the that information, such as the notes speculative as to their investment was inaccurate we can impeach them with evidence that they selected speculation on other brokerage account forms.

THE COURT: Thank you.

I think I would like to see more of the records that you are talking about in order to provide further guidance on that point. There are a number of variables that I can't see on the face of your comments, for example timing, which may be an issue, I will call it the blend of their account structure. It may be that 20 percent of their investments were invested with your client and some larger percentage of their accounts were with someone else and they used a much more -- different accounts, I will call it used a different risk profile with respect to those other accounts. I can't see whether the timing aligns for the accounts with your clients as opposed to the other accounts.

So, I think I need a little bit more data in order to provide you with clear guidance on that example.

MR. O'BRIEN: Well, your Honor, for example, there is some testimony, some witnesses have said that they were never a speculative investor, but we were able to show that in fact had multiple brokerage accounts in which they selected speculation as their investment objective. Our view would be that that was an appropriate use of those other brokerage account records to impeach the customer.

THE COURT: Thank you.

If that's the testimony at trial, I would consider inquiry using those records for impeachment purposes. Again, it will turn, in part, on the nature of the testimony at trial.

MR. TENREIRO: Your Honor, I think what we were getting at with our question was essentially defense counsel using that to raise areas that have already been ruled not relevant, and in order to elicit that kind of evidence to then use it for impeachment such as asking, *Don't you have account records that had a speculative investment strategy?*, knowing the answer because we have those records, the customer says, *I don't know, I don't remember, maybe, maybe not*, and then it is *Ah-ha! let me show you these accounts where you had a speculative investment objective*, and then these underlying rulings, and that information is not relevant for the reasons Court stated, is then before the jury.

THE COURT: Thank you. Understood.

We will confront this more clearly if and when the testimony is elicited at trial. To provide some guidance, however, I do not expect to, I will call it, permit defendants to create their own impeachment opportunity by acting as counsel for plaintiff has just hypothesized. Illustrated by the examples that I use, I expect that defendants would use this information for impeachment purposes with respect to testimony offered by a witness regarding an otherwise germane question where the response is they believe proven untrue by the relevant evidence.

So, I do not expect that plaintiffs or defendants would be opening the door to -- let me say defendants would be opening the door to purported impeachment use of these materials by asking questions that beg for impeachment.

So, I think that's the clearest guidance I can give at this time. Counsel for plaintiff will have to be focused on this issue during trial, but I appreciate your concern about that potential misuse of this ruling and I will expect to enforce it at trial.

MR. TENREIRO: Thank you, your Honor.

Unless Mr. O'Brien has other questions, I would like to hopefully quickly go through some of our procedural questions.

THE COURT: Thank you.

Mr. O'Brien, anything else?

MR. O'BRIEN: No, your Honor.

THE COURT: Thank you. Please proceed, counsel for plaintiff.

MR. TENREIRO: Thank you, your Honor. We had noted that the Court indicated that it wanted different colors for the stamps for exhibits, and I apologize, I have not been able to locate, to the extent the Court has trial procedure rules. Were there any particular colors or do you just leave it to us?

THE COURT: I will leave that decision to you.

MR. TENREIRO: Okay. Thank you, your Honor.

The next question was if the Court had reached sort of a decision on the jury selection method because we hoped to follow the Court's ruling that we give ideas on the voir dire questions by Friday. I was wondering if we were going to get those voir dire questions or we should give thoughts on the one we already got from the Richardson case.

THE COURT: Thank you. We will give you proposed voir dire questions I have and we will send those to you shortly.

MR. TENREIRO: Okay. Thank you.

Your Honor, is this the proper time to raise the verdict sheet. As the Court may recall, there is two wildly different approaches here and it is possible, after the Court's ruling today, we might be able to meet and confer on what the proper verdict sheet is. But, is there any guidance on what we should do there?

THE COURT: Thank you.

Just because of the hour, I think I am going to encourage the parties to meet and confer on that, to the extent there is ground to do so. As I said, we will have a charging conference during trial at that point, we will have the opportunity to review the verdict form.

MR. TENREIRO: Thank you, your Honor.

On the designation timeline, the timeline for designations of prior witnesses, the Court had given us until Friday. We respectfully request until Wednesday, first thing in the morning, we endeavor to provide everything to defense counsel by tomorrow night. But, given the holiday weekend and we also would like to meet and confer with counsel for defendant after we change objections, if we could do, send everything to the Court by Wednesday morning.

THE COURT: Thank you.

Counsel for defendants, what is your view?

MR. O'BRIEN: I think, your Honor, it depends how extensive the changes are but we are fine extending the deadline.

THE COURT: Thank you. That's fine. I am happy to adopt the proposal by the SEC. You can send in the materials by the date you described.

MR. TENREIRO: Your Honor, thank you.

We are going to work on revising the exhibit list given the rulings. To the extent there remain objections to the exhibit list, would it be helpful for the Court to rule on the remaining objections before trial and, if so, what is the timeline that the Court would wish the parties to present for any objections to the exhibits?

THE COURT: Thank you.

I will appreciate it if you can let me know what additional, or rather I should say what exhibits are objected to by either party in advance of trial. You told me during our final pretrial conference that most of the objections related to the motions *in limine*. I would welcome any way that you can convey to me which objections remain open. If you would like to do that by presenting an updated exhibit list, that would be helpful. But, if you think that another alternative vehicle would be more efficient, I'm happy to consider that as well.

MR. TENREIRO: Thank you, your Honor.

So, we will endeavor to present and update an exhibit list as soon as we can. We do believe that most objections will be resolved but there might be a handful.

THE COURT: Good.

MR. TENREIRO: Your Honor, the last issue on our list is to get the Court's view on what we propose do with respect to the video deposition, video testimony we will be presenting. We have discussed with our trial technicians and don't believe it is possible to have on the jurors' screen both the video and the exhibit that is being discussed. So, for those witnesses only, we propose to prepare binders of the exhibits and hand them out to the jurors so that they can follow along. But, if the Court has a preferred alternative methodology, we will follow that.

THE COURT: Thank you.

That will work well. Just remind me, if you will, please counsel, to advise the jurors to only look at the thing that they are told to look at. I think that that is something that I should say, it will be helpful, and if I don't say it please remind me that I should.

MR. TENREIRO: Thank you, your Honor. That's all we have, your Honor. Thank you.

THE COURT: Good. Thank you, all. I appreciate your patience throughout this and appreciate your thoughtfulness.

This proceeding is adjourned.

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Verdict Sheet
Ct. Ex 9
6/20/19

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-against-

DONALD J. FOWLER,

Defendant.

1:17-cv-139-GHW

VERDICT SHEET

Please indicate each of your verdicts with a check mark (✓).

1. Did the Defendant with scienter employ any device, scheme, or artifice to defraud, or engage in any act, practice, or course of business which operated or would operate as a fraud or deceit upon any person, in violation of **Section 10(b)** of the Securities Exchange Act (the "Exchange Act"), **Exchange Act Rules 10b-5(a)** or **10b-5(c)**, or **Section 17(a)(1)** of the Securities Act?

   Yes ✓ No ____

2. Did the Defendant with scienter make any untrue statement of a material fact, or any omission of a material fact, in violation of **Section 10(b)** of the Exchange Act and **Exchange Act Rule 10b-5(b)**?

   Yes ✓ No ____

3. Did the Defendant negligently obtain money or property by means of any untrue statement of a material fact, or by any omission of a material fact, in violation of **Section 17(a)(2)** of the Securities Act?

   Yes ✓ No ____

4. Did the Defendant negligently engage in any transaction, practice, or course of business which operated or would operate as a fraud or deceit upon the purchaser of a security, in violation of **Section 17(a)(3)** of the Securities Act?

   Yes ✓ No ______

5. Did the Defendant with scienter recommend an investment strategy with no reasonable basis to believe the strategy was suitable for any customer, in violation of **Section 10(b)** of the Exchange Act?

   Yes ✓ No ______

If Yes: **Do not answer** question 6. If No: **Answer** question 6.

6. Did the Defendant with scienter recommend an investment strategy to any of the following customers with no reasonable basis to believe the strategy was suitable for that customer, in violation of **Section 10(b)** of the Exchange Act?

Answer "Yes" or "No" as to each customer.

Kenneth J. Bayer:	Yes	______	No	______
Lane Clizbe:	Yes	______	No	______
Louis A. Dellorfano:	Yes	______	No	______
G. Allen Deuschle:	Yes	______	No	______
Steve B. Dimercurio:	Yes	______	No	______
Jeffrey Funk:	Yes	______	No	______
Bob Krueger:	Yes	______	No	______
Clay B. Miller:	Yes	______	No	______
Bobby Pilkington:	Yes	______	No	______
Al Riedstra:	Yes	______	No	______
Peter Skrna:	Yes	______	No	______
Robert Weathers:	Yes	______	No	______
Gary J. Wendorff:	Yes	______	No	______
Donald Womeldorph:	Yes	______	No	______

7. Did the Defendant with scienter make any unauthorized trade in the account of any of the following customers, in violation of **Section 10(b)** of the Exchange Act?

Answer "Yes" or "No" as to each customer.

Kenneth J. Bayer:	Yes	✓	No	
Lane Clizbe:	Yes	✓	No	
Louis A. Dellorfano:	Yes	✓	No	
G. Allen Deuschle:	Yes	✓	No	
Steve B. Dimercurio:	Yes	✓	No	
Jeffrey Funk:	Yes	✓	No	
Bob Krueger:	Yes	✓	No	
Clay B. Miller:	Yes		No	✓
Al Riedstra:	Yes	✓	No	
Peter Skrna:	Yes	✓	No	
Robert Weathers:	Yes	✓	No	
Gary J. Wendorff:	Yes	✓	No	
Donald Womeldorph:	Yes	✓	No	

SO SAY WE ALL

[redacted]

Signature of Foreperson

[redacted]

Name of Foreperson

USDC SDNY
DOCUMENT ELECTRONICALLY FILED
DOC #:
DATE FILED: 2/25/2020

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, -against- DONALD J. FOWLER, Defendant.	1:17-cv-139-GHW

MEMORANDUM OPINION AND ORDER

GREGORY H. WOODS, United States District Judge:

Defendant Donald J. Fowler misused his position as a broker to recommend a series of investments that were unsuitable to any investor. He implemented trades in his customers' accounts without their consent. His customers lost thousands, while Mr. Fowler profited from the substantial commissions that his trades generated. A jury unanimously found Mr. Fowler liable with respect to the charges mounted against him by the Securities and Exchange Commission in this case. Because the Court finds that there is a substantial likelihood that Mr. Fowler will again violate the securities laws, the Court will enter a permanent injunction to protect the public from future violations by Mr. Fowler. The Court also orders Mr. Fowler to disgorge his ill-gotten gains, and to pay Tier III penalties for each of his violations.

I. BACKGROUND

A. The Investigation and Resulting Complaint Against Fowler and Dean

This case developed out of an investigation of J.D. Nicolas, Inc. ("J.D. Nicolas") by the Securities and Exchange Commission (the "SEC"). The investigation began in 2014. Plaintiff's 56.1 Statement, Dkt. No. 70 ("P's 56.1 Statement"), ¶ 137. At the time of the investigation, Defendants Donald Fowler and Gregory Dean were brokers at the firm. *Id.* The SEC focused its investigation on Mr. Fowler and Mr. Dean, among others. *Id.* ¶¶ 136, 138. In April 2014, the SEC asked J.D. Nicolas to retain documents "created, modified, or accessed" by Messrs. Dean and Fowler. *Id.*

¶ 138. And in November of the same year, Mr. Fowler and Mr. Dean both provided investigative testimony to the SEC. *Id.* ¶ 138.

In March 2016—approximately a year and a half after his investigative testimony—Mr. Fowler entered into his first tolling agreement with the SEC. Declaration of Jorge G. Tenreiro, Dkt. No. 190 ("Tenreiro Decl."), Ex. X. The SEC and Mr. Fowler entered into another tolling agreement in August 2016. *Id.* Ex. Y. The Court is unaware of what transpired between the 2014 investigation and the 2016 tolling agreements. For purposes of this motion, what is significant is that, notwithstanding any conclusions reached as a result of the investigation, the SEC did not seek to enjoin Mr. Fowler from further conduct that would violate the securities laws, potentially harming his current and prospective customers. No request for injunctive relief was made by the SEC until after the close of trial in this matter.

But the SEC's investigation had unearthed something of great concern—the unsuitable investment strategies implemented by Messrs. Dean and Fowler in their customers' accounts. In January 2017, the SEC commenced this action against Mr. Fowler and Mr. Dean. Dkt. No. 1. The SEC alleged that Mr. Fowler and Mr. Dean "recommended to customers a high-cost trading strategy consisting of the excessive buying and selling of stocks." *Id.* at 1. The allegations targeted a series of trades allegedly implemented by Mr. Fowler and Mr. Dean in 27 customer accounts at J.D. Nicolas. *Id.* at 2. By the time that the complaint was filed, J.D. Nicolas had gone out of business. *Id.* at 4.

The complaint alleged that Mr. Fowler and Mr. Dean engaged in excessive trading in their customers' accounts, driving up transaction fees and costs on their customers' accounts to unconscionable levels. "Many of the accounts had cost-to-equity ratios in excess of 100%, with a couple over 200%, and one at 463.65%. The average annualized cost-to-equity ratio for these accounts was 110.90%, meaning that the customers, on average, had to realize 110.90% in profits just to break even." *Id.* at 8.

The complaint also contained allegations that Mr. Fowler and Mr. Dean churned several of their customers' accounts. *Id.* at 9. For example, the complaint focused on the trading in the account of one of Mr. Fowler's customers—Customer 24. "The average equity in Customer 24's account was only $54,739, but Fowler made a total of $1,709,242 in purchases, and each investment was held for an average of 10.9 days." *Id.* at 10.

On the basis of these allegations, the SEC claimed that Mr. Fowler and Mr. Dean violated Section 17(a) of the Securities Act of 1933 (the "Securities Act"), 17 U.S.C. § 77q(a), and Section 10(b) of the Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b–5 promulgated thereunder, 17 C.F.R. § 240.10b–5.

B. The Litigation Through Mr. Dean's Settlement on the Eve of Trial

After the complaint was filed, this case proceeded in the ordinary manner. The parties engaged in an extended period of discovery. Following the completion of discovery, the SEC and the defendants filed cross-motions for summary judgment. *See* Dkt. Nos. 52, 68. The Court denied both motions, Dkt. No. 91, and later scheduled trial to begin on June 10, 2019. Throughout the litigation, Mr. Dean and Mr. Fowler were represented by the same counsel—Liam O'Brien.

On the morning of June 10, 2019, while awaiting the arrival of the venire, the Court was informed that the SEC and Mr. Dean had agreed to resolve the SEC's claims against him. The Court entered a final judgment as to Mr. Dean later that day, implementing the resolution that had been agreed upon by the SEC and Mr. Dean. Dkt. No. 168.

That final judgment included, among other things, a permanent injunction, prohibiting Mr. Dean from violating the Securities Act or the Exchange Act. *Id.* at 1. The judgment also ordered that Mr. Dean pay disgorgement of "$253,881.98, representing profits gained as a result of the conduct alleged in the Complaint . . . and a civil penalty in the amount of $253,881.98." *Id.* at 3. Mr. Dean expressly consented to the relief entered by the Court. Dkt No. 159-1, at 1. In addition, Mr.

Dean admitted certain of the facts that led to his conclusion that he had violated the securities laws, namely that he "from 2011 through 2014: (a) knowingly or recklessly made trade recommendations to customers with no reasonable basis; (b) made material misrepresentations and omissions to customers; and (c) engaged in unauthorized trading in customer accounts." *Id.* at 7.

C. The Trial

1. The Verdict

In the wake of Mr. Dean's settlement, trial proceeded against Mr. Fowler alone. The evidence presented by the SEC against Mr. Fowler over the course of the following days was powerful, and ultimately persuasive. The SEC's case focused on the accounts of 13 of Mr. Fowler's clients. The jury unanimously found Mr. Fowler liable with respect to all of the SEC's six causes of action. The jury found that Mr. Fowler *with scienter* did "employ any device, scheme or artifice to defraud, or engage in any act . . . which would operate as a fraud or deceit on any person" in violation of identified sections of the Exchange Act. Verdict Sheet, Dkt. No. 169 (emphasis added). The jury also concluded that Mr. Fowler did "*with scienter* make any untrue statement or a material fact, or any omission of a material fact, in violation of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5(b)." *Id.* (emphasis added). He also "negligently obtain[ed] money or property by means of an[] untrue statement of a material fact, or by an[] omission of a material fact" in violation of Section 17(a)(2) of the Securities Act, *id.*, and negligently engaged in a transaction, practice, or course of business which operated or would operate as a fraud or deceit on the purchaser of a security, in violation of Section 17(a)(3) of the Securities Act. *Id.*

The jury specifically found that Mr. Fowler "with scienter recommend[ed] an investment strategy with no reasonable basis to believe the strategy was suitable for any customer, in violation of Section 10(b) of the Exchange Act." *Id.* And, moreover, the jury found that Mr. Fowler, again, acting with scienter, made unauthorized trades in the accounts of 12 of the 13 customer accounts

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that were the focus of the litigation.[1] *Id.*

These ultimate conclusions are dry, but damning. The Court will not recount the emotional testimony of several of Mr. Fowler's victims recounting their losses, and how they were injured as a result of Mr. Fowler's breach of their trust. The jury's conclusion says it all.

Not all of Mr. Fowlers' 13 customers at issue in the trial testified, either live or by deposition designation, but the testimony presented a consistent picture of Mr. Fowler's management of their accounts—describing substantial trading volume beyond their expectations, resulting in excessive costs. *See, e.g.* Trial Transcript ("Tr.") 173:14-16 ("Q: Was that in-and-out rapid trading activity, was that something that you were asking for? A: No, but I, I apparently let it happen."). There was also substantial evidence that Mr. Fowler disregarded the wishes of his customers, driving them to the strategies that the jury found to have been unsuitable. For example, after one of his customers wrote that his investment goal was "current income," through conversation, Mr. Fowler got the customer to "what he truly wanted." *Id.* 687:25-688:3; *see also id.* 688:8-14 ("He did want to have some level of income at one point or another, I'm not denying that, we had that conversation but for what he was doing in that . . . account . . . , he wanted speculation and I know that he wrote current income, but the conversation that him and I had were not accurate to just write in current income and that's it."); *id.* 690:6-10 ("Q: So, Mr. Weather said I don't use margin, right? A: He said that, yeah. Q: But he did use margin in your account. You had him sign a margin agreement, correct? A: He also used margin accounts, yes.").

Ultimately, the jury found that Mr. Fowler engaged in unsuitable trading in all of the customer accounts that were examined and engaged in unauthorized trading in 12 of 13 of his customers' accounts. The consequences of this conduct was significant, resulting in substantial losses for Mr. Fowler's clients, many of whom were not wealthy, and were ill-suited to suffer the

[1] The jury did not find that Mr. Fowler engaged in unauthorized trading in the account of Clay B. Miller.

consequences of Mr. Fowler's misconduct. In all instances in which the jury was asked the question, Mr. Fowler was found to have engaged in his misconduct with scienter.

2. Fowler's Background and Investment Strategy

Mr. Fowler testified at length. He explained that he had worked substantially his entire career in stock brokerage firms, starting with the predecessor firm for J.D. Nicolas in 2007. *Id.* 624:9-10. Mr. Fowler never graduated from college; he left SUNY Farmingdale after an illness, deciding to focus on building his "book of business." *Id.* 808:1-8. Mr. Fowler had limited instruction in finance and investment outside of his on-the-job training.

Early in his career, Mr. Fowler made cold-calls to find customers for the brokerage, but by 2011 he had graduated to pursuing leads generated by his junior, cold-calling colleagues. *Id.* 643:1-645:25. Hundreds of cold-calls were made from his office each day, working to identify prospects. *Id.* 645:11-21. Once a prospect was identified, he or she was handed over to a broker, such as Mr. Fowler, who then worked to persuade them to invest through his firm. After 2011, he did very little cold calling. *Id.*. 810:11-12. By then, his role had evolved, such that junior brokers would do the cold-calling and pass on leads to him. Mr. Fowler followed up on those leads to try to develop the leads into customers. *Id.* 810:23-811:10. By the time that he was managing the 13 accounts that were the focus of the trial, Mr. Fowler had developed his book of business to include nearly 100 individual customers at a time; and approximately 400 over the course of the years at issue. *Id.* 811:15-24.

Over the course of his years in the industry, Mr. Fowler obtained a number of licenses, including Series 7, Series 63, and Series 24. *Id.* 648:17-650:1. In order to obtain those licenses, Mr. Fowler had to pass a number of exams and was required to take continuing education classes regarding the responsibilities of brokers to their clients. *Id.* Mr. Fowler was aware of the rules and obligations imposed on him by FINRA, and, in particular the concepts of reasonable basis suitability—broadly, the requirement that a broker have a reasonable basis to believe that an investment is suitable for his customer, *id.* 650:7-651:22—and the concept of customer-specific suitability, which, broadly, requires that a trading strategy recommended for a customer must be suitable for a given customer, *id.* 652:10-21. He was also aware that he was prohibited from placing his own interests ahead of those of his clients. *Id.* 652:1-6.

It was in his role as a broker that Mr. Fowler invested assets in his customers' accounts—implementing trading ideas that he developed. He had limited formal education in business or investment. He took business classes at college before dropping out. *Id.* 808:2-4. Apart from that, he learned to invest on the job, through on the job training and his own reading. He has "read lots and lots of books throughout the years, a lot of webinars, stuff like that." *Id.* 808:13-15. He testified that he was particularly influenced by four books, "Investing in Stocks," "Event Trading," "One Good Trade," and "Trading Catalysts" "which was a very good book in regard to how an event-trading strategy works. I read that a few times." *Id.* 809:8-14. He also read a number of periodicals in the financial industry.

During his testimony, Mr. Fowler described the methodology that he used to develop ideas for the "event driven strategy" that he implemented for many of the customers who were the subject of this case. Mr. Fowler testified that he found his ideas in public documents. *Id.* 847:13-23 ("Q: With respect to your stock-specific recommendations, how did you come up with those recommendations? A: So, I'm constantly reading all the time. In regards to financial news, I would read different financial websites, research reports, different publications, 10-Q filings, anything I could get my hands on stock specific. I would read that. Q: What publications during that time period did you read regularly? A: Wall Street Journal I read regularly. Investor[']s Business Daily, those are probably the most.") Once he had an idea, Mr. Fowler did additional research. *Id.* 848:10-21 ("I would then typically look at the financials on a company. How big the company was, their float, that's the amount of shares that are actually out on the market trading. I'd look at insiders' buys and sales to see sentiment from an insider's standpoint. I would look at recent news, I would look at recent upgrades and downgrades by other research analysts that had coverage on the company. I would then essentially look at the chart and the history of the chart. I'd get an idea of the direction on where I thought the stock was going to trade. And then at that point in time, if it passed—if it passed through everything and got to the bottom, then I would make a recommendation."). Mr. Fowler did not describe any financial analysis associated with his proposed trades. Indeed, Mr. Fowler testified that he did not know the performance associated with his recommended strategies. *Id.* 696:24-697:10 ("Q: You are talking about hundreds of accounts; what was your performance? A: Again, I can point out plenty of accounts that have made plenty of money throughout the years. With that said, I have never done an analysis where I have taken all of my customer accounts and put it into a spreadsheet.").

From the Court's perspective, Mr. Fowler's testimony showed him to be alternatively dismissive, or fundamentally ignorant of, the problematic nature of the trading strategy that he implemented. Again, this is ultimately captured by the jury's verdict, but some excerpts from Mr. Fowler's testimony are illustrative. Mr. Fowler explained his view of the turnover ratio in his clients' accounts. He testified that "I don't view—and I testified to this earlier—turnover as the sole indicator of risk. You can look at turnover, and it can be indicative of higher risk due to the commissions that are tied to turnover. But turnover, in and of itself, you know, I don't view as indicative of anything really." *Id.* 670:15-20. Similarly, Mr. Fowler discredited the value of measuring the commission-to-equity ratio—a ratio that is broadly used in the industry and one that his own firm's supervisory manual recommended. *See id.* 751:15-752:15 (A: "[The cost-equity-ratio] is a totally distorted number and that's all I have to say about that. It is a distorted number that you cannot just look at commission equity and then figure out how much money this account needs in

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order to break even.").

Mr. Fowler may have felt obliged to express such disdain for those commonly used financial metrics because those of his customers dramatically exceeded the benchmarks established by his own firm for even its most risk-seeking customers. A high cost-equity ratio was considered to be 10%; but for the 13 customers of Mr. Fowler examined at trial, it was 142%. *Id.* 755:2-3, 25-756:3. And a turnover ratio of 4 was considered by Mr. Fowler's firm to be high; the turnover ratio for the 13 customers examined at trial was 116. *Id.* 756: 9-14.

Mr. Fowler was subject to "special supervision" while at J.D. Nicolas. *Id.* 319:15-320:9. While he was on special supervision, a supervisor would call three to five of his customers a month to 394:14-21. Mr. Fowler also received a substantial number of complaints regarding unsuitable recommendations and unauthorized trades while at J.D. Nicolas. *See, e.g.*, *id.* 703-4-709:10. He was aware that a number of his clients were unhappy with what he was doing with their money. *Id.* 698:15-20. He testified that he did nothing to change his strategy as a result of the complaints or the fact that he had been placed under special supervision as a result. *Id.*; *see also id.* 699:2-12 (Q: You acknowledged, in August of 2012, that you were placed under special supervision at J.D. Nicolas; right? A: Yes. Q: But nothing changed about how you were trading in your clients['] accounts after this, did it Mr. Fowler? A: The trading strategies essentially remained the same. . . . The strategy in and of itself did not change. Q: And the costs and the level of costs that you were implementing did not change, right? A: Correct.").

Rather than using the complaints to influence his manner of handling his customers' accounts, Mr. Fowler described the complaints about his strategy and the associated losses in a self-focused way—articulating his apparent view that such complaints are principally designed to support asset recovery efforts against him. In the Court's view, Mr. Fowler expressed a profound a lack of empathy regarding the impact of the strategies that he recommended to his customers, coupled with an inability or unwillingness to learn from his past mistakes. *See, e.g. id.* 703:21-704-6 ("When people lose money in the stock market, it is a business decision to file a complaint for them and ultimately there are kitchen sink claims that are often the same exact thing where they'll allege an unsuitable or an unauthorized transaction and, frankly, it puts the burden on me to prove that that was not the case in some sort of an arbitration proceeding. So, this, as far as customer filing complaints when there is an actual business around asset recovery for stock market losses, usually it's 80 percent of these complaints are from the same asset recovery firm, it is the same exact thing every time."); *see also id.* 706:9-16 ("Q: Why didn't you, to protect yourself from this business of filing complaints against brokers, do something? A: Well, I tried. Like I said, I tried. It didn't work. And, frankly, it wouldn't have changed anything. They would still say they were unauthorized. Even if you could prove that they were unauthorized they would still say unsuitable. It would still be the same kitchen sink claims.") Rather than considering that the complaints may have been the same every time because his conduct was inappropriate in the same way, Mr. Fowler discredited the complaints as routine and "kitchen sink." And he did nothing to change his own investment strategy in spite of the expressed concerns of certain of his customers, even after he was placed on special supervision.

In reaching its verdict, the jury must have concluded that Mr. Fowler's testimony was not credible. The Court did not find him to be credible either. For example, the jury found that Mr. Fowler executed unauthorized trades in 12 of his customers' accounts. However, Mr. Fowler testified that he spoke with his customers about each of his trades in advance. *See, e.g. id.* 764:19-21 (Q: And if there is [sic] 1,200 trades[,] your testimony is there is [sic] 1,200 phone calls? A: That's correct."). Similarly, Mr. Fowler testified that he spoke about his commissions with each of his clients on a "recommendation-by-recommendation" basis. *Id.* 817:3-20. But the phone records introduced by the SEC did not show evidence of phone calls regarding Mr. Fowler's customers' trades—and the jury reasonably concluded that Mr. Fowler's sworn version of events at trial was false. Similarly, in finding that Mr. Fowler acted with scienter, the jury concluded that Mr. Fowler's testimony regarding his asserted beliefs with respect to the reasonableness of his strategy was not credible.

3. The Impact of Fowler's Misconduct

In the aggregate, the 13 customers at issue in the trial suffered total losses of $467,627 during the period in which Mr. Fowler was servicing their accounts. Tenreiro Decl. Ex. C (PX-1A). All of those customers lost money. *Id.* The substantial losses of Mr. Fowler's customers came during a period in which the S&P 500 Index maintained substantial growth.

Much of the customers' losses was the result of the very high amount of commissions that Fowler charged his clients. Mr. Fowler's sole source of income from J.D. Nicolas was the receipt of commissions generated by his customers' trades. Tr. 614:14-16. As a result, Mr. Fowler had substantial personal motivation to engage in the misconduct found by the jury. From the commissions paid, twenty percent went to J.D. Nicolas, Mr. Fowler's firm. The remainder of the commissions for each of the 13 of Mr. Fowler's customers at issue in trial were shared 50/50 by Mr. Fowler, and his partner, Mr. Dean. *Id.* 614:22-24.

For the 13 customers at issue in the trial, the aggregate commissions charged by J.D. Nicolas between 2011 and 2014 were as shown in the following table. Tenreiro Decl. Ex. D (PX-1G). Of these sums, Mr. Fowler personally received 40% of the commissions generated. The SEC seeks disgorgement of those amounts.

Account Name	Aggregate Commissions	Fowler's Take
Kenneth J. Bayer	$13,537	$5,414.80
Lane Clizbe	$9,445	$3,778.00
Louis A. Dellorfano	$23,292	$9,316.80
G. Allen Deuschle	$20,993	$8,397.20

Steve B. DiMercurio	$24,912	$9,964.80
Jeffrey Funk	$16,097	$6,438.80
Bob Krueger	$8,493	$8,4930
Clay B. Miller	$20,437	$8,174.80
Al Riedstra	$13,870	$5,548.00
Peter Skrna	$13,097	$5,238.80
Robert & Glenna Weathers	$33,805	$13,522.00
Gary J. Wendorff	$27,755	$11,102.00
Donald Womeldorph Jr.	$35,735	$14,294.00
Total	$261,466	$104,568.40

In addition, Mr. Fowler received half of the "postage fees" charged to his customers; the other half was paid to his partner, Mr. Dean. Tenreiro Decl. Ex. I (PX-234), at 9. In the aggregate, the 13 customers at issue during the trial paid $54,996 in postage fees, of which Mr. Fowler received $27,498. PX-1G.

The SEC also presented evidence regarding the commissions paid by a number of Mr. Dean's customers during the same period. Those commissions summed up to $508,672 across the period. *Id.* The evidence presented at trial supports the conclusion that 40% of Mr. Dean's customer's commissions (totaling approximately $203,469) were shared with Mr. Fowler. Mr. Dean's customers also paid a substantial amount of "postage fees" that were split with Mr. Fowler. The SEC requests that the Court order disgorgement of those amounts by Mr. Fowler as well.

II. ANALYSIS

A. Disgorgement

1. Legal Standard[2]

"Once the district court has found federal securities law violations, it has broad equitable power to fashion appropriate remedies, including ordering that culpable defendants disgorge their profits." *SEC v. Razmilovic*, 738 F.3d 14, 31 (2d Cir. 2013) (quotation omitted). Disgorgement "consists of factfinding by a district court to determine the amount of money acquired through wrongdoing . . . and an order compelling the wrongdoer to pay that amount plus interest to the court." *SEC v. Cavanagh*, 445 F.3d 105, 116 (2d Cir. 2006). Unlike other remedies, disgorgement is not designed to compensate victims or to punish wrongdoers, *id.* at 116 n. 25, 117, but is instead meant to deter wrongdoing by "forcing a defendant to give up the amount he was unjustly enriched," *id.* at 117 (quotation omitted).

To determine the amount of money acquired through wrongdoing, courts apply a two-part burden shifting framework. *See FTC v. Bronson Partners, LLC*, 654 F.3d 359, 368 (2d Cir. 2011); *see also SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 1996). First, the agency seeking disgorgement must "show that its calculations reasonably approximate[] the amount of the defendants' unjust gains." *Bronson Partners*, 654 F.3d at 368 (brackets and quotation omitted). Once the agency has met that burden, "defendants [can attempt] to show that [the agency's] figures [are] inaccurate," *id.* (quotation omitted), or that some of the gains were not the result of wrongdoing, *Razmilovic*, 738 F.3d at 31. A defendant's burden is high, however. If the agency has made a reasonable approximation, "the risk of uncertainty falls on the wrongdoer whose illegal conduct created the uncertainty." *Bronson Partners*, 654 F.3d at 368 (quotation omitted); *see also Razmilovic*, 738 F.3d at 31 (holding that the risk

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[2] The legal analysis in this and subsequent sections of this opinion is drawn with appreciation from the accurate description of the applicable legal principles in *S.E.C. v. Amerindo Inv. Advisors Inc.*, No. 05 CIV. 5231 RJS, 2014 WL 2112032 (S.D.N.Y. May 6, 2014) (Sullivan, J.), *aff'd sub nom. S.E.C. v. Amerindo Inv. Advisors*, 639 F. App'x 752 (2d Cir. 2016).

of uncertainty falls on the wrongdoer as long as the agency's "measure of disgorgement is reasonable").

In making the disgorgement calculation, the proper focus is revenues, not profits. *See Bronson Partners*, 654 F.3d at 375 ("[W]here the profits from fraud and the defendant's ill-gotten gains diverge, the district court may award the larger sum."). Defendants "are not entitled to deduct costs associated with committing their illegal acts." *Id.* (quotation omitted). Nevertheless, courts should deduct any money that a defendant returns or has returned to her or his victims. *See id.* at 369; *cf. SEC v. First Jersey Secs., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996) (approving a district court's decision to credit defendants for money they had already paid to victims as part of a private settlement). Defendants are "only required to give back the proceeds of [their] securities fraud once." *SEC v. Palmisano*, 135 F.3d 860, 863 (2d Cir. 1998) (quotation omitted).

As part of the disgorgement judgment, a court may order a defendant to pay prejudgment interest to "prevent[the] defendant from obtaining the benefit of what amounts to an interest free loan." *SEC v. Moran*, 944 F. Supp. 286, 295 (S.D.N.Y. 1996); *see also SEC v. Koenig*, 557 F.3d 736, 745 (7th Cir. 2009) (noting that prejudgment interest is designed to take account of "inflation and the power of money to earn an economic return"). A district court has discretion both in deciding whether to require prejudgment interest and in setting the appropriate interest rate. *See First Jersey Secs.*, 101 F.3d at 1476. "The personal wrongdoing of a defendant should be considered in determining that an award of interest is in accord with doctrines of fundamental fairness. In the context of Section 10(b) and Rule 10b–5 actions, proof of scienter is sufficient to justify an award of prejudgment interest." *S.E.C. v. Musella*, 748 F. Supp. 1028, 1042–43 (S.D.N.Y. 1989), *aff'd*, 898 F.2d 138 (2d Cir. 1990) (citations omitted).

2. Application

The SEC argues that Mr. Fowler should disgorge the full amount of the commissions and "postage fees" that he received from the 13 clients who were the subject of the trial. The SEC also asks that the Court order disgorgement of his portions of commissions on Mr. Dean's accounts. The Court takes up the question of whether the SEC has satisfied its burden to show the amount of Mr. Fowler's gains with respect to each of these two categories in turn.

The SEC has clearly met its burden to prove the amount of the commissions and "postage fees" extracted by Mr. Fowler from his 13 customers. The SEC presented evidence at trial regarding each of the 13 accounts, including the trading history in each of the accounts and the commissions and "postage fees" paid. The jury found that Mr. Fowler's strategy with respect to each of the accounts was unsuitable. Of those commission amounts, however, Mr. Fowler personally received only 40% of the total because a 20% fee was first paid to J.D. Nicolas, and he shared the remaining 80% with his partner, Mr. Dean. Therefore, the Court concludes that Mr. Fowler was unjustly enriched by $104,568.40 in commissions as a result of his fraud on his 13 customers. He also received $27,498 in "postage fees" from those clients. Mr. Fowler has presented no argument to rebut the SEC's proof with respect to these amounts. Consequently, the Court will order disgorgement in the amount of $132,076.40. Because Mr. Fowler acted with scienter, an award of prejudgment interest is warranted. The Court will apply prejudgment interest at the underpayment rate established for the Internal Revenue Service pursuant to 26 U.S.C. § 6621.

The Court concludes that the SEC has not met its burden with respect to Mr. Dean's customers who were not the subject of the trial. It is worthwhile to flash back to the procedural history of the case. On the morning of the trial, the SEC was planning to present a case against both Mr. Fowler and Mr. Dean. When Mr. Dean settled with the SEC, the SEC culled its case and limited the direct evidence of fraud to the 13 customers who were principally serviced by Mr. Fowler. As a result, there was relatively little evidence presented regarding the management of Mr. Dean's accounts. The trial included evidence of the aggregate losses in Mr. Dean's accounts, and the costs associated with them. But the SEC, understandably, did not focus its proof at trial on the management of those accounts.

Instead, as evidence of fraudulent conduct with respect to those accounts, the SEC asks the Court to rely on the admission provided by Mr. Dean in connection with the consent order of judgment entered against him. In it, as noted above, Mr. Dean admitted that he "from 2011 through 2014: (a) knowingly or recklessly made trade recommendations to customers with no reasonable basis; (b) made material misrepresentations and omissions to customers; and (c) engaged in unauthorized trading in customer accounts." Dkt No. 159-1, at 7. And he agreed, as part of the judgment to pay "$253,881.98, representing profits gained as a result of the conduct alleged in the Complaint . . . ." *Id.* at 3.

On this record, the Court declines to infer that the commissions on Mr. Dean's accounts were necessarily the product of fraud. The language of Mr. Dean's admission does not tie to the specific accounts to which the SEC now points. Without more detail to link each account to Mr. Dean's admitted misconduct, the Court is left to take an inferential leap to conclude that the accounts identified by the SEC were the affected ones.[3]

The Court is also conscientious of the fact that the information that links Mr. Dean's accounts to fraudulent conduct was not presented at trial, and that Mr. Fowler did not have the opportunity to challenge it as evidence of an obligation on his part to pay any amount as disgorgement. While both Mr. Dean and Mr. Fowler were represented by the same lawyer, the Court is mindful that, ultimately, these were admissions of Mr. Dean only. Therefore, the Court will not order that Mr. Fowler disgorge the amount of commissions that he received from Mr. Dean's customers' accounts.

[3] This is a gap that the SEC might readily have filled with a more detailed set of admissions from Mr. Dean.

B. Civil Penalties

1. Legal Standard

In addition to disgorgement, federal statutes authorize three increasing tiers of civil fines for violations of the securities laws. *See* 15 U.S.C. §§ 77t(d)(2) (Securities Act), 78u(d)(3)(B) (Exchange Act), 80b9(e)(2)(IAA). For any violation, a court may impose Tier I penalties-fines of up to the higher of (1) $5,000 for each violation by a natural person or $50,000 for each violation by "any other person," such as a corporation; or (2) the defendant's "gross amount of pecuniary gain." *See* 15 U.S.C. §§ 77t(d)(2)(A), 78u(d)(3)(B)(i), 80b9(e)(2)(A). If a violation "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," a court may instead impose Tier II penalties—fines of up to the higher of (1) $50,000 for each violation by a natural person or $250,000 for each violation by "any other person"; or (2) the defendant's "gross amount of pecuniary gain." 15 U.S.C. §§ 77t(d)(2)(B), 78u(d)(3) (B)(ii), 80b–9(e)(2)(B). If a violation "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," and "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons," a court may instead impose Tier III penalties—fines of up to the higher of (1) $100,000 for each violation by a natural person or $500,000 for each violation by "any other person"; or (2) the defendant's "gross amount of pecuniary gain." 15 U.S.C. §§ 77t(d)(2)(C), 78u(d)(3)(B) (iii), 80b–9(e)(2)(C).[4]

A defendant's gross amount of pecuniary gain is similar to that defendant's disgorgement amount, but with three differences. First, gross pecuniary gain, unlike disgorgement, may consider gains only from frauds occurring within the five-year statute of limitations for civil penalties. *See* *Gabelli v. SEC*, 568 U.S. 442, 447-448 (2013) (interpreting 28 U.S.C. § 2462). Second, because the

[4] The amount of these statutory penalties are adjusted by the SEC by regulation. *See* 17 C.F.R. § 201.1001. For the period from March 4, 2009 to March 5, 2013, which embraces most of the period at issue here, the maximum Tier III penalty was $150,000 for each violation by a natural person. *Id.* The maximum penalty was $160,000 thereafter. *Id.*

civil penalties statutes focus on the gross amount of pecuniary gain—as opposed to disgorgement, which is focused on simple gains—defendants are not entitled to deduct money returned to victims. Otherwise, a defendant who paid back all gains before judgment could practically nullify the statutory penalty. Third, disgorgement can be awarded jointly and severally, but civil penalties cannot. *See S.E.C. v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 287-88 (2d Cir. 2013). Nevertheless, where multiple defendants mutually benefitted from the same gains, the best calculation of a single defendant's gain may be the total gains obtained by the group through that defendant's violations. *See SEC v. Great Am. Techs., Inc.*, No. 07 Civ. 10694 (DC), 2010 WL 1416121, at *2 (S.D.N.Y. Apr. 8, 2010) (in a case where a corporate defendant gained $2.3 million and an individual defendant personally diverted $1 million of that sum, fining the individual defendant based on the full $2.3 million gain), *aff'd sub nom. SEC v. Setteducat*e, 419 F. App'x 23 (2d Cir. 2011). Hence, there may be some overlap among defendants' gains, and the gains attributed to each defendant may add up to over one hundred percent of total gains.

"Beyond setting maximum penalties, the statutes leave the actual amount of the penalty . . . up to the discretion of the district court." *Razmilovic*, 738 F.3d at 38 (quotation omitted); *see also* 15 U.S.C. §§ 77t(d)(2)(A) ("The amount of the penalty shall be determined by the court in light of the facts and circumstances."), 78u(d)(3)(B)(i) (same), 80b–9(e)(2)(A) (same). "In exercising this discretion, courts weigh (1) the egregiousness of the defendant's conduct; (2) the degree of the defendant's scienter; (3) whether the defendant's conduct created substantial losses or the risk of substantial losses to other persons; (4) whether the defendant's conduct was isolated or recurrent; and (5) whether the penalty should be reduced due to the defendant's demonstrated current and future financial condition." *SEC v. Tourre*, 4 F. Supp. 3d 579, 593 (S.D.N.Y. 2014) (quotation omitted).

The penalty provisions of the relevant securities laws do not define "violation," 15 U.S.C. §§

77t(d), 78u(d)(3), 80b–9(e). As a result, courts have determined the number of violations using a variety of methods. *See In re Reserve Fund Secs. and Derivative Litig.*, Nos. 09 MD 2011, 09 Civ. 4346 (PGG), 2013 WL 5432334, at *20 (S.D.N.Y. Sept. 30, 2013). For example, a court can look to the number of investors defrauded or the number of fraudulent transactions to determine the number of violations. *Id.* (*citing Pentagon Capital Mgmt. PLC*, 725 F.3d at 288 n.7) (approving district court's methodology of counting each trade as a separate violation); *SEC v. Elliot*, No. 09 Civ. 7594 (KBF), 2012 WL 2161647, at * 11 (S.D.N.Y. June 12, 2012) (counting each transaction as a separate violation); *SEC v. Glantz*, No. 94 Civ. 5737(LAP), 2009 WL 3335340, at *6 (S.D.N.Y. Oct. 13, 2009) (assessing one violation for each victim); *SEC v. Milan Capital Grp., Inc.*, No. 00 Civ. 108 (DLC), 2001 WL 921169, at *3 (S.D.N.Y. Aug. 14, 2001) (same); *SEC v. Kenton Capital Ltd.*, 69 F.Supp.2d 1, 17 n.15 (D.D.C. 1998) (same)). In the alternative, a court may consider the number of statutes that each defendant violated, or whether the violations were all part of a single scheme. *Id.* (*citing SEC v. Shehyn*, No. 04 Civ. 2003 (LAP), 2010 WL 3290977, at *8 (S.D.N.Y. Aug. 9, 2010) (assessing penalty for each statute violated); *SEC v. Johnson*, No. 03 Civ. 177(JFK), 2006 WL 2053379, at *10 (S.D.N.Y. July 24, 2006) (assessing penalty for each statutory violation found by jury); *SEC v. Rabinovich & Assocs., LP*, No. 07 Civ. 10547(GEL), 2008 WL 4937360, at *6 (S.D.N.Y. Nov. 18, 2008) (finding one violation where defendant's conduct was part of "single scheme or plan")).

2. Application

Tier III penalties are clearly appropriate for Mr. Fowler. The jury found him liable of several counts of securities fraud. As a result, there is no doubt that his conduct "involved fraud." His conduct was egregious. Many of Mr. Fowler's clients were relatively unsophisticated. And the Court believes that the evidence at trial established that Mr. Fowler took advantage of the relative lack of sophistication of some of his clients to bilk them. As described above, and as found by the jury, the strategy employed by Mr. Fowler was unsuitable for anyone. Mr. Fowler disregarded the

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outrageously high cost-to-equity and turnover ratios of his customers' accounts, which exceeded his firm's guidance for risk-seeking customers by many multiples. And he traded in 12 of their accounts without authorization.

Mr. Fowler was found by the jury to have acted with scienter. And as described above, he was aware that customers had complained about his investment strategy. In response to those known complaints, Mr. Fowler chose to do nothing to change his strategy. Mr. Fowler's conduct resulted in substantial losses in his customers' accounts—thousands of dollars that some could ill afford to lose. And his conduct was recurrent—he applied the strategy again and again to the 13 customers at issue in the trial. The Court acknowledges that the 13 customers at issue were a fraction of his 400 accounts over the relevant period. But the number of affected customers was substantial, and the evidence revealed a repeated pattern of misconduct by Mr. Fowler. Mr. Fowler has presented no evidence or argument regarding his inability to pay a penalty assessed by the Court.

The Court will impose a third-tier penalty on Mr. Fowler of $150,000 with respect to each of the 13 customers whose accounts were the focus of the trial. While Mr. Fowler implemented the same unsuitable strategy for each of the 13 accounts, the Court does not believe that penalties should be assessed as if this was a single scheme. It was not, for example, a scheme derived from a single offering. *See e.g., SEC v. Riel*, 282 F. Supp. 3d 499, 529 (N.D.N.Y. 2017); *SEC v. Locke Capital Mgmt., Inc.*, 794 F. Supp. 2d 355, 370-71 (D.R.I. 2011). Instead, as Mr. Fowler argued throughout the trial, he approached each of his customers individually. The 13 customers at issue in his trial were only a subset of his entire customer base. Mr. Fowler selected his victims for this conduct individually; therefore, treating his treatment of each of his defrauded customers as a separate violation best effectuates the purposes of the statute. While the Court has the authority to impose penalties for each of the trades in those customers' accounts, the Court declines to do so for two reasons: first, because each set of trades within a given defrauded customer's account could be considered to be part of a single scheme to defraud that individual; and, second simply because the resulting award would be so substantial that the Court does not believe that Mr. Fowler would reasonably be capable of satisfying the award. Therefore, the Court will impose a third-tier penalty of $150,000 for each of Mr. Fowler's 13 victims—for a total of $1,950,000.

C. Permanent Injunction

1. Legal Standard

The SEC may seek permanent injunctive relief for violations of the Securities Act, and the Exchange Act. *See* 15 U.S.C. §§ 77t(b) (Securities Act); 78u(d)(l) (Exchange Act). To obtain such relief, "[t]he SEC must demonstrate that there is a substantial likelihood of future violations of illegal securities conduct." *SEC v. Cavanagh*, 155 F.3d 129, 135 (2d Cir. 1998); *see also SEC v. Gabelli*, 653 F.3d 49, 61 (2d Cir. 2011) (quoting *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1100 (2d Cir. 1972)), *rev'd on other grounds sub nom. Gabelli v. SEC*, 582 U.S. 442 (2013) (requiring a showing of a "reasonable likelihood that the wrong will be repeated."); *Sec. & Exch. Comm'n v. Gentile*, 939 F.3d 549, 556 (3d Cir. 2019) ("Unless the agency shows a real threat of future harm, 'there is in fact no lawful purpose to be served' by a preventive injunction." (quoting *SEC v. Torr*, 87 F.2d 446, 450 (2d Cir. 1937)).

To evaluate whether there is a substantial likelihood of future violations of the securities laws, courts look to the following factors: (1) the fact that a defendant has been found liable for illegal conduct; (2) the degree of scienter involved; (3) whether the infraction is an isolated occurrence; (4) whether the defendant continues to maintain that his past conduct was blameless; and (5) whether the defendant might be in a position where future violations could be anticipated. *Cavanagh*, 155 F.3d at 135 (citation omitted). Ultimately, "in deciding whether to grant injunctive relief, a district court is called upon to assess all those considerations of fairness that have been the traditional concern of equity courts. Accordingly, the adverse effect of an injunction upon defendants is a factor to be considered by the district court in exercising its discretion." *Manor Nursing Centers, Inc.*, 458 F.2d at 1102.

2. Application

The entry of a permanent injunction against Mr. Fowler is warranted here. As described above, Mr. Fowler was found liable for securities fraud with respect to 13 of his customers' accounts. He made unauthorized trades in 12 of those customers' accounts. Mr. Fowler acted with a high degree of scienter. The jury found that he engaged in that misconduct with scienter. Mr. Fowler testified that he was aware of the FINRA's suitability rules, but he implemented a trading strategy that flagrantly violated them. He did so despite the fact that he had received complaints from other customers regarding the suitability of his strategies, and was placed on special supervision as a result. Those complaints put Mr. Fowler on notice regarding the potential impropriety of his conduct, yet he engaged in the conduct charged in this case.

Mr. Fowler's offenses here were not isolated. He was proven to have engaged in this course of misconduct with 13 clients over the course of three years. And, as just noted, the evidence of prior complaints involving Mr. Fowler suggests that he may have engaged in similar practices with other customers not examined during the course of this trial.

Mr. Fowler continues to assert that his conduct was blameless. Mr. Fowler had every right to defend himself vigorously in this case and the Court does not hold the fact that he did so against him in any way. However, Mr. Fowler's testimony regarding his views on investments generally, and the propriety of his conduct show him to present a substantial risk of future injury to his customers. As described above, Mr. Fowler discredited standard industry metrics designed to measure the risk of his strategies. Mr. Fowler did not analyze the performance of his recommended strategies, or even, according to his testimony, conduct financial analysis of his recommended trades. Mr. Fowler's professed disdain of commonplace financial metrics suggests that he presents a continuing risk to customers.

So too does Mr. Fowler's apparent lack of interest in learning from past mistakes. Confronted with customer complaints regarding the unsuitability of his trading strategy, Mr. Fowler did nothing to reconsider his strategy. Instead, he belittled the complaints as "kitchen sink" and blustered forward with his approach, disregarding client feedback, and, in the case of these 13 customers, the clear data showing that his strategies were unsuitable to any investor. No one excerpt from the trial testimony can capture what the Court observed over the course of Mr. Fowler's days of testimony: he presented himself disdainful of his customers' concerns, and unjustifiably satisfied with his performance in the face of concrete evidence of his malfeasance and data showing the terrible investment returns for all the 13 clients examined at trial. Mr. Fowler's overconfidence may make him a good salesman, but it also makes him a danger to future customers.

Mr. Fowler continues to work in the securities industry. He has worked in the industry since he left college, so the likelihood that he will be in a position to commit further violations is very high.

All of the factors laid out in *Cavanagh* weigh heavily in favor of the entry of a permanent injunction against Mr. Fowler. Mr. Fowler argues that an injunction is not warranted because of the long delay between the commission of his misconduct and the trial. He argues that the SEC's failure to pursue an injunction earlier supports the conclusion that no injunction is necessary. He also points to the absence of evidence of similar misconduct by Mr. Fowler in the period after 2014. The Court appreciates the argument that the SEC might have taken more prompt action to protect Mr. Fowler's customers from similar misconduct. But ultimately, it is the Court, not the SEC, that must determine whether the entry of an injunction is warranted. The SEC's delay in seeking an injunction does not bear significant weight in the Court's analysis given the substantial evidence supporting the need for entry of injunctive relief against Mr. Fowler.

The Court has considered Mr. Fowler's argument that the events at issue in the trial are now dated. However, the evidence of the events proven at trial amply support the Court's conclusion that an injunction is warranted. The Court has little assurance that Mr. Fowler's conduct has changed in the intervening years: to the Court's knowledge, the SEC did not examine those years. The Court is hesitant to rely on the word of Mr. Fowler, given the jury's conclusion that, contrary to his sworn testimony, he engaged in unauthorized trades. Moreover, Mr. Fowler's testimony at trial in 2019 reflected his continued belief in the propriety of his abusive investment strategies and his disregard for financial metrics commonly used to measure the risk of investment strategies. Mr. Fowler's testimony dates from 2019, not 2014, and supports the Court's conclusion that injunctive relief remains necessary here.

The Court is very mindful of the potential impact of this type of injunctive relief on Mr. Fowler and the stigma that it places on him in the industry. The Court has weighed that harm. But ultimately, "the public interest, when in conflict with private interest, is paramount." *SEC v. Culpepper*, 270 F.2d 241, 250 (2d Cir. 1959). The Court finds that Mr. Fowler presents a continuing substantial risk of future securities violations, and will enter an injunction requiring him to fully comply with those laws in the future.

III. conclusion

For the reasons stated above, the SEC's motion is GRANTED. Mr. Fowler is ordered to disgorge $132,076.40, plus prejudgment interest at the underpayment rate established for the Internal Revenue Service pursuant to 26 U.S.C. § 6621. Mr. Fowler is further ordered to pay civil penalties in the amount of $1,950,000. The Court will also permanently enjoin Mr. Fowler from further violations of the securities laws.

The SEC is directed to submit an appropriate proposed permanent injunction and form of judgment within 14 days of the entry of this Memorandum Opinion and Order. The SEC is also directed to submit to the Court a letter by the same date, setting forth its calculation of prejudgment interest, attaching an Excel spreadsheet to show its calculations. The spreadsheet should also be submitted in native format to the Court's chambers email account, copying counsel for the defendant.

The Clerk of Court is directed to terminate the motion pending at Dkt. No. 189.

SO ORDERED.

Dated: February 25, 2020
New York, New York

GREGORY H. WOODS
United States District Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, **Plaintiff,** **-against-** **DONALD J. FOWLER,** **Defendant.**	**17-CV-139 (GHW)** **ECF Case**

FINAL JUDGMENT AS TO DEFENDANT DONALD J. FOWLER

Plaintiff Securities and Exchange Commission ("Plaintiff" or "Commission") having filed a Complaint and a jury trial having been held between June 10 and June 19, 2019, as to the Commission's claims against Defendant Donald J. Fowler ("Defendant") and the jury having returned a verdict for Plaintiff as to all claims against the Defendant on June 20, 2019:

I.

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that Defendant is permanently restrained and enjoined from violating, directly or indirectly, Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. § 78j(b)] and Rule 10b-5 promulgated thereunder [17 C.F.R. § 240.10b-5], by using any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, in connection with the purchase or sale of any security:

(a) to employ any device, scheme, or artifice to defraud;

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that, as provided in Federal Rule of Civil Procedure 65(d)(2), the foregoing paragraph also binds the following who receive actual notice of this Judgment by personal service or otherwise: (a) Defendant's agents, servants, employees, and attorneys; and (b) other persons in active concert or participation with Defendant or with anyone described in (a).

II.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that Defendant is permanently restrained and enjoined from violating Section 17(a) of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. § 77q(a)] in the offer or sale of any security by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly:

(a) to employ any device, scheme, or artifice to defraud;

(b) to obtain money or property by means of any untrue statement of a material fact or any omission of a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(c) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that, as provided in Federal Rule of Civil Procedure 65(d)(2), the foregoing paragraph also binds the following who receive actual notice of this Judgment by personal service or otherwise: (a) Defendant's agents, servants, employees, and attorneys; and (b) other persons in active concert or participation with Defendant or with anyone described in (a).

III.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that Defendant shall pay disgorgement of $132,085.20, prejudgment interest thereon of $35,195.04, and a civil penalty in the amount of $1,950,000, for a total of $2,117,280.24.

Defendant shall satisfy his obligations to pay the foregoing amounts of disgorgement, prejudgment interest, and civil penalties ordered pursuant to this paragraph by paying the amounts ordered to the Securities and Exchange Commission within fourteen (14) days after entry of the relevant order.

Defendant may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request. Payment may then also be made directly from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm. Defendant may also pay by certified check, bank cashier's check, or United States postal money order payable to the Securities and Exchange Commission, which shall be delivered or mailed to

Enterprise Services Center
Accounts Receivable Branch
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

and shall be accompanied by a letter identifying the case title, civil action number, and name of this Court; Defendant as a defendant in this action; and specifying that payment is made pursuant to this Judgment and any order regarding disgorgement, prejudgment interest, and/or civil penalties.

Defendant shall simultaneously transmit photocopies of evidence of payment and case identifying information to the Commission's counsel in this action. By making this payment, Defendant will relinquish all legal and equitable right, title, and interest in such funds and no part of the funds shall be returned to Defendant.

IV.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Defendant under this Judgment or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Defendant of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

V.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that this Court shall retain jurisdiction of this matter for the purposes of enforcing the terms of this Judgment.

VI.

There being no just reason for delay, pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, the Clerk is ordered to enter this Judgment forthwith and without further notice.

Dated: February 28, 2020

HONORABLE GREGORY H. WOODS
UNITED STATES DISTRICT JUDGE

KeyCite Yellow Flag - Negative Treatment
Proposed Legislation

United States Code Annotated
Title 15. Commerce and Trade
Chapter 2A. Securities and Trust Indentures (Refs & Annos)
Subchapter I. Domestic Securities (Refs & Annos)

15 U.S.C.A. § 77t

§ 77t. Injunctions and prosecution of offenses

Effective: July 22, 2010
Currentness

(a) Investigation of violations

Whenever it shall appear to the Commission, either upon complaint or otherwise, that the provisions of this subchapter, or of any rule or regulation prescribed under authority thereof, have been or are about to be violated, it may, in its discretion, either require or permit such person to file with it a statement in writing, under oath, or otherwise, as to all the facts and circumstances concerning the subject matter which it believes to be in the public interest to investigate, and may investigate such facts.

(b) Action for injunction or criminal prosecution in district court

Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter, or of any rule or regulation prescribed under authority thereof, the Commission may, in its discretion, bring an action in any district court of the United States, or United States court of any Territory, to enjoin such acts or practices, and upon a proper showing, a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this subchapter. Any such criminal proceeding may be brought either in the district wherein the transmittal of the prospectus or security complained of begins, or in the district wherein such prospectus or security is received.

(c) Writ of mandamus

Upon application of the Commission, the district courts of the United States and the United States courts of any Territory shall have jurisdiction to issue writs of mandamus commanding any person to comply with the provisions of this subchapter or any order of the Commission made in pursuance thereof.

(d) Money penalties in civil actions

(1) Authority of Commission

Whenever it shall appear to the Commission that any person has violated any provision of this subchapter, the rules or regulations thereunder, or a cease-and-desist order entered by the Commission pursuant to section 77h-1 of this title, other than by committing a violation subject to a penalty pursuant to section 78u-1 of this title, the Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, upon a proper showing, a civil penalty to be paid by the person who committed such violation.

(2) Amount of penalty

(A) First tier

The amount of the penalty shall be determined by the court in light of the facts and circumstances. For each violation, the amount of the penalty shall not exceed the greater of (i) $5,000 for a natural person or $50,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation.

(B) Second tier

Notwithstanding subparagraph (A), the amount of penalty for each such violation shall not exceed the greater of (i) $50,000 for a natural person or $250,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation, if the violation described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(C) Third tier

Notwithstanding subparagraphs (A) and (B), the amount of penalty for each such violation shall not exceed the greater of (i) $100,000 for a natural person or $500,000 for any other person, or (ii) the gross amount of pecuniary gain to such defendant as a result of the violation, if--

(I) the violation described in paragraph (1) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

(II) such violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons.

(3) Procedures for collection

(A) Payment of penalty to Treasury

A penalty imposed under this section shall be payable into the Treasury of the United States, except as otherwise provided in section 7246 of this title and section 78u-6 of this title.

(B) Collection of penalties

If a person upon whom such a penalty is imposed shall fail to pay such penalty within the time prescribed in the court's order, the Commission may refer the matter to the Attorney General who shall recover such penalty by action in the appropriate United States district court.

(C) Remedy not exclusive

The actions authorized by this subsection may be brought in addition to any other action that the Commission or the Attorney General is entitled to bring.

(D) Jurisdiction and venue

For purposes of section 77v of this title, actions under this section shall be actions to enforce a liability or a duty created by this subchapter.

(4) Special provisions relating to a violation of a cease-and-desist order

In an action to enforce a cease-and-desist order entered by the Commission pursuant to section 77h-1 of this title, each separate violation of such order shall be a separate offense, except that in the case of a violation through a continuing failure to comply with such an order, each day of the failure to comply with the order shall be deemed a separate offense.

(e) Authority of court to prohibit persons from serving as officers and directors

In any proceeding under subsection (b), the court may prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who violated section 77q(a)(1) of this title from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 78*l* of this title or that is required to file reports pursuant to section 78*o*(d) of this title if the person's conduct demonstrates unfitness to serve as an officer or director of any such issuer.

(f) Prohibition of attorneys' fees paid from Commission disgorgement funds

Except as otherwise ordered by the court upon motion by the Commission, or, in the case of an administrative action, as otherwise ordered by the Commission, funds disgorged as the result of an action brought by the Commission in Federal court, or as a result of any Commission administrative action, shall not be distributed as payment for attorneys' fees or expenses incurred by private parties seeking distribution of the disgorged funds.

(g) Authority of a court to prohibit persons from participating in an offering of penny stock

(1) In general

In any proceeding under subsection (a) against any person participating in, or, at the time of the alleged misconduct, who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such period of time as the court shall determine.

(2) Definition

For purposes of this subsection, the term “person participating in an offering of penny stock” includes any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.

CREDIT(S)

(May 27, 1933, c. 38, Title I, § 20, 48 Stat. 86; Pub.L. 100-181, Title II, § 208, Dec. 4, 1987, 101 Stat. 1253; Pub.L. 101-429, Title I, § 101, Oct. 15, 1990, 104 Stat. 932; Pub.L. 104-67, Title I, § 103(b)(1), Dec. 22, 1995, 109 Stat. 756; Pub.L. 107-204, Title III, §§ 305(a)(2), 308(d)(3), Title VI, § 603(b), July 30, 2002, 116 Stat. 779, 785, 795; Pub.L. 111-203, Title IX, § 923(a)(1), July 21, 2010, 124 Stat. 1849.)

Notes of Decisions (324)

15 U.S.C.A. § 77t, 15 USCA § 77t
Current through P.L. 116-150.

End of Document

United States Code Annotated
Title 28. Judiciary and Judicial Procedure (Refs & Annos)
Part VI. Particular Proceedings
Chapter 163. Fines, Penalties and Forfeitures (Refs & Annos)

28 U.S.C.A. § 2462

§ 2462. Time for commencing proceedings

Currentness

Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.

CREDIT(S)

(June 25, 1948, c. 646, 62 Stat. 974.)

Notes of Decisions (221)

28 U.S.C.A. § 2462, 28 USCA § 2462
Current through P.L. 116-150.