SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Release No. 10115 / July 27, 2016

SECURITIES EXCHANGE ACT OF 1934
Release No. 78429 / July 27, 2016

INVESTMENT ADVISERS ACT OF 1940
Release No. 4463 / July 27, 2016

INVESTMENT COMPANY ACT OF 1940
Release No. 32194 / July 27, 2016

Admin. Proc. File No. 3-15918

In the Matter of

DENNIS J. MALOUF

OPINION OF THE COMMISSION

SECURITIES ACT PROCEEDING

EXCHANGE ACT PROCEEDING

ADVISERS ACT PROCEEDING

INVESTMENT COMPANY ACT PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Fraud

Aiding and Abetting and Causing Fraud

Failure to Seek Best Execution

Respondent, the former president and majority owner of a registered investment adviser, violated the antifraud provisions of the federal securities laws when he failed to disclose conflicts and correct misleading statements concerning ongoing payments that he received from the owner of a branch office of a broker-dealer that he had once owned. Respondent directed clients' highly liquid, AAA-rated Treasury and agency bond purchase transactions to his former broker-dealer, despite claims in registered investment adviser's Forms ADV and website that its investment advice and choice of broker-dealers were impartial and conflict-free. Respondent also failed to seek best execution for advisory clients' Treasury and agency bond trades by directing trades to his former broker-dealer without first seeking multiple competing bids, resulting in clients' payment of excessive commissions. Respondent aided and abetted and caused investment adviser's related violations. *Held*, it is in the public interest to bar the respondent from associating with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; prohibit respondent from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; order the respondent to cease and desist from committing or causing any violations or future violations of the provisions violated; order disgorgement of $562,001.26, plus prejudgment interest; and assess a civil money penalty of $75,000.

APPEARANCES:

Alan M. Wolper and Heidi VonderHeide, Ulmer & Berne LLP, Chicago, IL, for Dennis J. Malouf.

Stephen C. McKenna, *Dugan Bliss*, and *John H. Mulhern*, for the Division of Enforcement.

Appeal filed: April 27, 2015
Last brief received: October 29, 2015

Dennis J. Malouf ("Malouf"), an investment adviser, appeals from an initial decision finding that from January 2008 to March 2011, he violated, and aided and abetted and caused UASNM, Inc.'s ("UASNM") violations of, the antifraud provisions of the federal securities laws when he failed to disclose a conflict of interest to his investment adviser clients concerning his order flow to, and receipt of payments from, a broker-dealer branch that he once owned; and failed to seek best execution for clients' bond transactions that he directed to the broker-dealer branch.[1] The ALJ barred Malouf from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for a period of seven-and-a-half years; prohibited him from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor

[1] *Dennis J. Malouf*, Initial Decision Release No. 766, 2015 WL 1534396 (Apr. 7, 2015).

of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter for a period of seven-and-a-half years; imposed a civil money penalty of $75,000; and ordered him to cease and desist from committing or causing violations of the provisions in question. The ALJ declined to order disgorgement, finding instead that the $1,068,084 Malouf received from the owner of the broker-dealer branch is "clearly identifiable as legal profits and should not be the subject of disgorgement."[2]

The Division of Enforcement appeals the ALJ's imposition of a seven-and-a-half-year industry bar against Malouf, contending that a permanent bar is a more appropriate sanction. The Division also argues that Malouf should be ordered to pay disgorgement. Malouf appeals both the ALJ's findings of violation and sanctions.

We base our findings on an independent review of the record. We find that Malouf violated Sections 17(a)(1) and 17(a)(3) of the Securities Act; Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c) thereunder; and Sections 206(1) and 206(2) of the Advisers Act.[3] We also find that Malouf aided and abetted and caused his firm's violations of Sections 206(4) and 207 of the Advisers Act and Rule 206(4)-1(a)(5) thereunder.[4] Based on our findings of violations and public interest determination, we impose bars without a right to reapply, order Malouf to cease and desist from committing or causing violations of the provisions listed above, and order him to pay disgorgement of $562,001.26 and a $75,000 civil penalty.

I. FACTS

A. Malouf's Ownership Interest in the Broker-Dealer and Investment Adviser Firms

Malouf purchased a branch of Raymond James Financial Services, Inc. ("RJ") in approximately February 1999 and was a registered representative and owner of the branch until the end of 2007. In September 2004, Malouf and Kirk Hudson ("Hudson"), a fellow RJ registered representative, purchased UASNM from Joseph Kopczynski ("Kopczynski"), who was then Malouf's father-in-law.[5] For the next three years, Malouf owned both UASNM and the RJ

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[2] In addition to the violations the ALJ found, the OIP in this matter charged Malouf with acting as an unregistered broker, alleging primarily that Malouf received selling compensation in the form of commissions from the broker-dealer when he was not associated with a registered broker-dealer, in violation of Exchange Act Sections 15 and 15C. 15 U.S.C. §§ 78*o*, 78*o*-5. The ALJ found that a preponderance of the evidence did not support these charges. The Division did not appeal this aspect of the ALJ's decision, and we do not review this finding on appeal.

[3] 15 U.S.C. §§ 77q(a)(1) and 77q(a)(3); 78j(b); 80b-6(1) and (2); and 17 C.F.R. § 240.10b-5(a) and (c).

[4] 15 U.S.C. §§ 80b-6(4) and 80b-7; and 17 C.F.R. § 206(4)-1(a)(5).

[5] After the purchase, Malouf was the 59.5 percent owner, CEO, and president, and Hudson was the 39.5 percent owner, CFO, and Chief Investment Officer. Kopczynski maintained a one percent ownership interest and was UASNM's Chief Compliance Officer until the end of 2010. Malouf served as UASNM's CCO from January through May 2011.

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branch office, and the two shared the same office space, with RJ renting a few cubicles. From 2004 to 2007, UASNM's Forms ADV disclosed Malouf's ownership of the RJ branch and noted that he might receive compensation for UASNM clients' transactions executed through the RJ branch.

B. Malouf's Sale of the RJ Branch and Receipt of Payments

In 2007, RJ became concerned about potential conflicts of interest and supervision risks resulting from Malouf's ownership of both UASNM and the RJ branch and requested that Malouf choose whether he wished to continue to associate with UASNM or RJ. Malouf decided to discontinue his association as a registered representative with RJ and, in January 2008, sold the RJ branch to Maurice Lamonde ("Lamonde"), a friend and former RJ co-worker of Malouf.[6] Despite the sale, the RJ branch continued to be located in UASNM's office space.

Malouf and Lamonde agreed that Lamonde's purchase price for the RJ branch would be two times the branch's trailing revenue, for a total purchase price of approximately $1.1 million. Pursuant to the Purchase of Practice Agreement ("PPA") between Malouf and Lamonde,[7] Lamonde was to make monthly payments to Malouf over a four-year period, totaling approximately 40 percent of the branch's revenue. However, Lamonde did not make monthly payments to Malouf; instead, payments were made sporadically on no set schedule with no specific correlation to the branch's revenue, and sometimes Lamonde made more than one payment in a given month, a practice Malouf described as "prepayment." Malouf frequently pressed Lamonde to make payments. Malouf stipulated that, on several occasions in the UASNM/ RJ branch office space, he asked Lamonde "where's my check [for the RJ branch]" in the presence of other employees. And Lamonde testified that Malouf, at times, requested immediate cash payments from Lamonde, even though the PPA envisioned monthly payments. To pay Malouf, in addition to using funds from the branch's operations, Lamonde testified that

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Malouf and Hudson registered UASNM with the Commission on September 4, 2004. Its March 2014 Form ADV, the most recent Form ADV in the record, reported that UASNM held approximately $275 million in assets under management.

6 Lamonde was an RJ registered representative from March 2000 until August 2011. He died in April 2014, but the ALJ admitted into the record portions of his earlier investigative testimony.

7 Although Malouf and Lamonde testified that they executed a PPA in January 2008, no witness other than Malouf and Lamonde testified to seeing the PPA until June 2010. Throughout 2009, an RJ Regional Director repeatedly pressed Lamonde for a copy of the PPA, but Lamonde failed to provide one. Lamonde finally produced a PPA in June 2010, dated January 2, 2008, but the signature page was not notarized until June 11, 2010. The RJ Regional Director testified that he felt this situation was "inappropriate." While it appears that there may, in fact, have been no executed agreement prior to June 2010, neither Malouf nor the Division disputes the general terms of the RJ branch sale (including that Lamonde was to make periodic payments to Malouf or the total amount of money that Lamonde owed Malouf).

he took twelve cash advances from RJ, borrowed against a personal life insurance policy, took money from his father-in-law, and took on credit card debt.

C. Malouf's Routing of Transactions to the RJ Branch

From January 2008 through March 2011, Malouf directed a substantial majority of UASNM clients' bond trades to the RJ branch for execution. Malouf had primary responsibility for UASNM's clients' bond trades (especially large-dollar-amount trades in excess of $1 million) and was considered the firm's bond expert. From 2008 to 2011, UASNM placed over 200 bond trades with the RJ branch, representing approximately 90 percent of its total bond trading. While various hearing witnesses estimated that Malouf personally placed anywhere between 60-95 percent of UASNM's total bond trades,[8] Malouf said he placed between 60-70 percent of the trades. Malouf stipulated that Hudson reviewed UASNM's clients' bond trades with broker-dealers other than RJ (roughly 10 percent of the total UASNM bond trades during this period) and determined that those trades were executed mostly by UASNM advisers other than Malouf, which demonstrates that Malouf placed few bond trades with non-RJ broker-dealers.

The transactions that Malouf directed to the RJ branch produced significant commissions for the RJ branch, which Lamonde used to pay Malouf pursuant to the PPA. According to Lamonde, he "passed along all or almost all of the commissions . . . from bond trading on behalf of UASNM back to Malouf." As Malouf agreed, he traded through the RJ branch "because then he got paid."[9] Lamonde made payments to Malouf toward his purchase of the RJ branch totaling $1,068,084, an amount almost equal to the total commissions ($1,074,454) the RJ branch earned on UASNM clients' bond trades.

D. Lack of Disclosure and Assurances in UASNM's Forms ADV and Website

UASNM's Forms ADV from February 2008 through March 2011, filed with the Commission and distributed to UASNM's clients, failed to disclose Malouf's receipt of payments from Lamonde. These forms also did not contain the prior disclosures that had been included in

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[8] Hudson, who was in litigation against Malouf when he testified, stated that Malouf was responsible for "90-plus % of the [UASNM] bond trades," based on his review of all UASNM bond trades for the 2008-2011 period. Matthew Keller ("Keller"), a fellow UASNM representative, testified that Malouf was primarily responsible for all bond trading at the firm and that Malouf "executed 80-90% of [UASNM's bond] trades on a long-term basis."

[9] Malouf continued to run UASNM until May 2011, when he was terminated based on the charges that are the subject of this proceeding. Thereafter, Kopczynski and Hudson took control of UASNM, and UASNM sued Malouf in state court in New Mexico ("State Court Litigation"). As part of the settlement of the State Court Litigation, Malouf received $1.1 million for his majority ownership of UASNM. Of that amount, Malouf agreed to pay $506,083.74 to UASNM clients and another $100,000 to pay a civil penalty we imposed against UASNM in a settled enforcement action. *UASNM, Inc.*, Advisers Act Release No. 3846, 2014 WL 2568398 (June 9, 2014). Malouf currently owns New Mexico Wealth Management, LLC, an investment adviser registered with the state of New Mexico.

the 2004-2007 Forms ADV regarding Malouf's ownership of the RJ branch and potential for compensation or the payment arrangement between Malouf and Lamonde. Instead, UASNM's Forms ADV from 2008 through 2011 stated that UASNM's selection of an executing broker was not based "upon any arrangement between the recommended broker and UAS[NM.]" UASNM's April 2010 Form ADV said that "employees of UASNM are not registered representatives of … RJ … and do not receive any commissions or fees from recommending these services."

UASNM's website also did not disclose the arrangement between Malouf and Lamonde, and asserted that UASNM provided impartial investment advice and that its brokerage recommendations were not "based upon any arrangement between the recommended broker and UASNM" and that UASNM "vigorously maintain[s its] independence to ensure absolute objectivity drives [its] decisions in managing [its] clients' portfolios." The website promised that UASNM's advice was "void of conflicts of interest."

Malouf delegated to Kopczynski the primary responsibility for preparing and filing UASNM's Forms ADV and for ensuring that its marketing materials, including its website, were accurate and complied with applicable regulations. He nonetheless had significant involvement with the Forms ADV, the website, and their contents. Although Kopczynski was the CCO of UASNM and Hudson had certain compliance responsibilities (including signing the Forms ADV on the firm's behalf), Malouf was—in his own estimation—the "top dog."

Malouf acknowledged that, as CEO of the firm, he was at least "partially responsible" for UASNM's Forms ADV and website. To that end, Malouf reviewed some of the Forms ADV between 2008 and 2011 "focusing on disclosures relating to himself and [the RJ branch]." Malouf acknowledged that he played a key role in the "creative part of [the website]." He admitted that "[w]hile he may not have read every word of UASNM's website, he was familiar with its contents" and that he "probably read" the statements on the website in 2008 that UASNM provided independent advice and had no arrangements with broker-dealers.

Malouf and UASNM also employed the services of an outside compliance consultant, Adviser Compliance Associates, LLC ("ACA"), whose lead consultant on UASNM's account was Michael Ciambor. ACA and Ciambor reviewed UASNM's compliance procedures and Forms ADV, and it performed annual reviews in which it identified compliance deficiencies and provided advice regarding ways that the firm could improve compliance.

E. Others involved in UASNM's compliance procedures were not aware of the payments.

Malouf acknowledged that his financial arrangement with Lamonde created a conflict of interest that should have been disclosed, but thought Kopczynski, Hudson, and ACA were responsible for making such disclosures. But while Kopczynski and Hudson were aware that Malouf had sold the RJ branch to Lamonde and had at least some general awareness that Malouf received periodic payments from Lamonde, they testified they did not know the specific timing and amounts of the payments made, which was why they did not insist on disclosures of those payments.

And it is undisputed—and Malouf admitted—that ACA was not aware that Malouf had received *any* payments from Lamonde until June 2010, 2.5 years after the payments began. Ciambor testified, and Malouf does not dispute, that Malouf told him in May or June 2008 that Malouf's "relationship from that point forward with Raymond James had been effectively severed." Ciambor also testified that, when he interviewed Malouf in June 2009 as part of ACA's compliance review, Malouf did not disclose to him that he had already received over $500,000 in payments from Lamonde. Immediately after receiving that information, ACA informed UASNM that it needed to make disclosures of the arrangement in its Forms ADV and on its website. UASNM finally made such a disclosure for the first time, in its March 2011 Form ADV, at Malouf's request (as CCO) after receiving the instructions from ACA.

F. Malouf did not seek multiple competing bids for the clients' bond transactions before he directed them to the RJ branch.

UASNM's compliance procedures required the firm to attempt to obtain three bids from different broker-dealers prior to placing a trade. UASNM registered representative Matthew Keller ("Keller") regularly followed this policy with respect to his clients' bond trades. Malouf, however, conceded that he regularly failed to seek multiple bids for UASNM clients' highly-liquid, AAA-rated treasury and agency bond trades or from brokers other than RJ, and that he should have done so. He admitted that he likely could have received better prices for his clients if he had followed UASNM's policy.[10]

Malouf testified that an appropriate commission for a $1 million U.S. Treasury bond would be one percent, and for larger trades commissions should drop to 0.5 percent or even lower. Malouf and Lamonde orally agreed that one percent was the maximum commission rate RJ would charge UASNM for Treasury and agency bond trades. However, many of the large-dollar-amount trades for UASNM clients, which were primarily handled by Malouf, had commissions above one percent, with some exceeding that rate by 50 percent.[11] Numerous bond trades executed by RJ had commissions exceeding the one percent level.

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[10] ACA relied on interviews with UASNM personnel and documentation the firm provided to determine that UASNM followed a policy of seeking multiple competing bids before placing bond trades with a broker-dealer. UASNM did not, however, provide ACA with trade blotters that reflected the specific commission amounts of any trades, and Ciambor understood that UASNM maintained documentation supporting its multi-bid process for only a limited number of its total trades.

[11] Hudson testified that Malouf complained to Kopczynski and other members of the UASNM investment committee about RJ's decision to *reduce* the commission on a $3.8 million UASNM client bond trade from 1% to 0.5%, which Hudson believed was strange since he understood these commissions were being paid to RJ and Lamonde, not to Malouf.

II. VIOLATIONS

Based on the conduct described above, Malouf is charged with violating Sections 17(a)(1) and 17(a)(3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5(a) and 10b-5(c) thereunder, and Sections 206(1) and 206(2) of the Advisers Act. Specifically, the OIP alleges that Malouf failed to disclose the conflict that arose as a result of his "secret commission arrangement" and that, as a result, UASNM made misleading disclosures in its Forms ADV and on its website. Malouf is not charged with violating Rule 10b-5(b), which prohibits "making" a misstatement of material fact, or Section 17(a)(2), which prohibits "obtain[ing] money or property by means of" a misstatement. Malouf argues that "to prove its claims under Securities Act Section l7(a)(l) and (3), Exchange Act Section l0(b) and Rules 10b-5(a) and (c) and Advisers Act Sections 206(1) . . . the Division was required to establish that [he] *made* a material misrepresentation or omission." (emphasis added). His argument and this case thus presents the following legal question: When may a respondent be held primarily liable for his conduct as part of a fraud involving misstatements, when the respondent did not himself "make" the misstatements for purposes of Rule 10b-5(b)? We set out below our analysis of this question.[12]

A. Primary Liability Under Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, Section 17(a) of the Securities Act, and Section 206 of the Advisers Act.

Lower courts have adopted varying approaches to liability under Exchange Act Rule 10b-5 (which implements Exchange Act Section 10(b)) and Section 17(a) of the Securities Act. The Supreme Court's recent decision in *Janus Capital Group v. First Derivative Traders* resolved some of the differences among the lower courts, as it clarified—and limited—the scope of liability under Rule 10b-5(b).[13] The decision was silent, however, as to Rule 10b-5(a) and (c) and Section 17(a), each of which Malouf is charged with violating.[14] The decision also did not address Section 206 of the Advisers Act (which Malouf is also charged with violating).

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[12] The Commission previously outlined this analysis in *John P. Flannery*, Exchange Act Release No. 73840, 2014 WL 7145625, at *9-19 (Dec. 15, 2014), *vacated on other grounds*, 810 F.3d 1 (1st Cir. 2015).

[13] 131 S. Ct. 2296 (2011).

[14] There is a divergence of views on the scope of these provisions among federal district courts. *Compare, e.g.*, *SEC v. Monterosso*, 768 F. Supp. 2d 1244, 1269 (S.D. Fla. 2011) (stating that "to be primarily liable for Rule 10b-5(a)'s prohibition of employment of a device, scheme, or artifice to defraud, one 'need only have made an intentionally deceptive contribution to an overall fraudulent scheme'") (citation omitted) *with SEC v. Langford*, No. 8:12CV344, 2013 WL 1943484, at *8 (D. Neb. May 9, 2013) (stating that Rule 10b-5(a) and (c) may be used only to charge conduct that is "beyond" or "distinct from" any "alleged misrepresentation or omission") *and SEC v. Kelly*, 817 F. Supp. 2d 340, 345 (S.D.N.Y. 2010) (stating that, in misstatement cases, as long as the defendant did not "make" the misstatement, even conduct "beyond" the misstatement cannot be charged under Rule 10b-5(a) or (c)).

1. Primary Liability Under Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5(a) and (c)

a. Section 10(b) covers conduct that is manipulative or deceptive.

Our analysis begins with the scope of Section 10(b), which prohibits the use or employment, in connection with the purchase or sale of any security, of "any manipulative or deceptive device or contrivance in contravention of" Commission rules.[15] "Manipulative," the Supreme Court has explained, is "a term of art when used in connection with securities markets," referring to practices "such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity."[16] Although the Court has not made a similar pronouncement on the meaning of "deceptive," it has consulted dictionaries in use in the 1930s to define other terms in Section 10(b);[17] those dictionaries define "deceptive" as "having power to mislead" or "[t]ending to deceive," and define "deceive" as "to impose upon; deal treacherously with; cheat" or "[t]o cause to believe the false or to disbelieve the true."[18] These definitions led one federal appeals court to conclude that "deceptive" encompasses "a wide spectrum of conduct involving cheating or trading in falsehoods."[19] Informed by these precedents, we conclude that to employ a "deceptive" device or to commit a "deceptive" act is to engage in conduct that produces a false impression.[20] Such conduct encompasses "making" a misrepresentation; it also encompasses, among other things, drafting or devising a misrepresentation.

This view comports with the notion that the reach of Section 10(b) should be construed in a manner at least as protective as the common law. The Supreme Court itself has recognized that Section 10(b) was "in part designed to *add* to the protections provided investors by the common law."[21] The courts have therefore held that it would be "highly inappropriate" to construe Section 10(b) "to be more restrictive in substantive scope than its common law analogs."[22]

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15 15 U.S.C. § 78j(b).

16 *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476 (1977).

17 *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 nn. 20, 21 (1976) (consulting the 1934 edition of Webster's International Dictionary to define other terms in Section 10(b)).

18 Webster's International Dictionary 679 (2d ed. 1934).

19 *SEC v. Dorozkho*, 574 F.3d 42, 50 (2d Cir. 2009) (consulting the 1934 edition of Webster's International Dictionary for the meaning of "deceptive").

20 *See Stewart v. Wyoming Cattle-Ranche Co.*, 128 U.S. 383, 388 (1888) ("The gist of the action [for deceit] is fraudulently producing a false impression upon the mind of the other party."); *United States v. Finnerty*, 533 F.3d 143, 148 (2d Cir. 2008) ("Broad as the concept of 'deception' may be, it irreducibly entails some act that gives the victim a false impression."); *see also Clark v. Capital Credit & Collection Services, Inc.*, 460 F.3d 1162, 1174 n.10 (9th Cir. 2006) ("Something is deceptive if it tends or has the power to 'give a false impression.'").

21 *Basic Inc. v. Levinson*, 485 U.S. 224, 244 n.22 (1988) (citing *Herman & MacLean v. Huddleston*, 459 U.S. 375, 388-389 (1983)) ("[T]he antifraud provisions of the securities laws

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We find particularly persuasive case law regarding the common law offense of obtaining property by false pretenses.[23] The offense dates back to an English statute of 1757, on which many state-law criminal statutes were modeled.[24] A false representation in violation of these criminal provisions could "assume any form: [it] may be oral or written . . . or it may be implied from conduct."[25] As the Massachusetts Supreme Judicial Court explained in 1844, a person commits the offense even where he convinces someone else to act on his behalf: "[A]ll that is necessary to be proved is, that he is at the time acting in concert with [the person who ultimately delivers the misstatement] and aiding in putting forth the false pretenses . . . with his knowledge, concurrence, and direction"[26] A century later, the same court confirmed that a defendant may be

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are not coextensive with common law doctrines of fraud. Indeed, an important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common law protections by establishing higher standards of conduct in the securities industry.")).

[22] *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1044 (7th Cir. 1977); *see also Harris v. American Inv. Co.*, 523 F.2d 220, 224 (8th Cir. 1975) (internal citation omitted) ("Although the federal securities laws in several instances offer greater protection to buyers and sellers of securities than do common law fraud concepts, common law fraud concepts underlie the securities laws and provide guidance as to their reach and application."); Louis Loss and Joel Seligman, Fundamentals of Securities Regulation 910-13 (4th ed. 2004) (noting that although "courts have repeatedly held that the fraud provisions in the SEC Acts . . . are not *limited* to circumstances that would give rise to a common law action for deceit," in light of "the legislative background it seems reasonable to assume at the very least that the most liberal common law views on these questions should govern under the statutes.").

[23] *See Frazier v. Commonwealth*, 165 S.W.2d 33, 34 (Ky. 1942) ("The gist of the offense of obtaining money or property of another by false pretenses is the fraud and deception of the perpetrator."); *accord People v. Harrington*, 267 P. 942, 945 (Cal. Dist. Ct. App. 1928); *Hicks v. State*, 215 S.W. 685, 686 (Ark. 1919); *Burney v. State*, 59 So. 306, 307 (Ala. Ct. App. 1912); *see also State v. Matthews*, 28 S.E. 469, 469 (N.C. 1897) (stating that the false pretense statutes proscribe "induc[ing] another person to believe a fact is really in existence, when it is not").

[24] 30 Geo. II, c. 24 (1757); LaFave, 3 Subst. Crim. L. §§ 19.7 (2d ed.); LaFave, 3 Subst. Crim. L. §§ 19.7, 19.8; 3 Charles E. Torcia, Wharton's Criminal Law §410, at 517 (15th ed. 1993). The Model Penal Code renamed these offenses theft by deception. American Law Institute, Model Penal Code and Commentaries 180-181 (1980).

[25] Wharton's Criminal Law §413, at 527; *accord* Rollin M. Perkins, Criminal Law 299 & n.19 (2d ed. 1969).

[26] *Commonwealth v. Harley*, 48 Mass. (7 Met.) 462, 465-466 (1844) (stating that "if A procures B to go to C" with a false pretense and thereby obtain the goods of C then "A is guilty in the matter of obtaining these goods by false pretenses"); *see also Cowen v. People*, 14 Ill. 348, 352 (1853) ("[I]f the false representations were made in pursuance of a mutual agreement between the defendants, it was immaterial which actually made them; both were equally liable."); *cf. Commonwealth v. Call*, 38 Mass. (21 Pick.) 515, 523 (1839) ("A false

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held liable even if there are "no false statements attributable to" the defendant, so long as the misrepresentations to the defrauded parties "are based upon and substantiated by [the defendant's] false statements."[27] Thus, as these cases and others make clear, false-pretenses liability does not require "that the defendant himself make the false representation."[28] In our view, a modern understanding of what conduct may be deemed "deceptive" should not be any narrower than this historical approach.[29]

b. Rule 10b-5(a) and (c) proscribe employing any manipulative or deceptive device, scheme, or artifice to defraud or engaging in any manipulative or deceptive act, practice, or course of business.

Rule 10b-5 implements the Commission's authority under Section 10(b).[30] Rule 10b-5(a) prohibits "employ[ing] any device, scheme, or artifice to defraud."[31] Rule 10b-5(b) prohibits "mak[ing] any untrue statement of a material fact or [omitting] to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."[32] And Rule 10b-5(c) prohibits "engag[ing] in any act, practice, or course of

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representation, made to the agent of Parker and by him communicated to Parker upon which he acted was, in legal contemplation, a false representation made to Parker himself. It was designed to influence him, and whether communicated to him directly, or through the intervention of an agent, can make no difference. It was intended to reach and operate upon his mind. It did reach it and produced the desired effect upon it, viz. the payment of the money. And it is immaterial whether it passed through a direct or circuitous channel.").

27 *Commonwealth v. Hamblen*, 225 N.E.2d 911, 915 (Mass. 1967) (involving fraud on a corporation).

28 Wharton's Criminal Law §415, at 530; *see also Commonwealth v. Camelio*, 295 N.E.2d 902, 905 (Mass. App. Ct. 1973) ("[T]he "paradigm of a number of cases resulting in conviction" for false pretenses is a "joint venture to defraud in which the defendant furnished his accomplice with false reports, the accomplice submitted them to the [defrauded parties,] and the defendant received moneys as a result."); *cf., e.g.*, *Brackett v. Griswold*, 20 N.E. 376, 379 (N.Y. 1889) (stating that to maintain an common law action for fraud or deceit based on false pretenses it is "not necessary that the false representation should have been made by the defendant personally" and that if "he authorized and caused it to be made, it is the same as though he made it himself").

29 *See Cady, Roberts & Co.*, 40 S.E.C. 907, 1961 WL 60638, at *3 (Nov. 8, 1961) (recognizing that Section 10(b) and Rule 10b-5 "are broad remedial provisions aimed at reaching misleading or deceptive activities, whether or not they are precisely and technically sufficient to sustain a common law action for fraud and deceit").

30 *See United States v. Zandford*, 535 U.S. 813, 816 n.1 (2002).

31 17 C.F.R. § 240.10b-5(a).

32 *Id.* § 240.10b-5(b).

business which operates or would operate as a fraud or deceit upon any person."[33] Liability under all three subsections requires a showing of scienter.[34]

Malouf is charged with violating Rule 10b-5(a) and (c). Whereas Rule 10b-5(b) (which Malouf is *not* charged with violating) is limited to liability for making false statements and omissions, Rule 10b-5(a) and (c) "are not so restricted."[35] The use in Rule 10b-5(a) and (c) of the terms "'fraud,' 'deceit,' and 'device, scheme, or artifice' provide a broad linguistic frame within which a large number of practices may fit."[36] Indeed, we have explained that Rule 10b-5 is "designed to encompass the infinite variety of devices that are alien to the climate of fair dealing . . . that Congress sought to create and maintain."[37] The Supreme Court, too, has recognized that Section 10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any' are obviously meant to be inclusive."[38] The Court therefore has instructed that they "must be read flexibly, not technically or restrictively" in order to achieve their remedial purposes.[39]

Nonetheless, liability under Rule 10b-5 cannot "extend beyond conduct encompassed by Section 10(b)'s prohibition."[40] And the "language of Section 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception."[41] Because a

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33 *Id.* § 240.10b-5(c).

34 *Hochfelder*, 425 U.S. at 194. Scienter is an "intent to deceive, manipulate, or defraud." *Id.* at 193 & n.12. It may be established through a heightened showing of recklessness. *Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1093 (D.C. Cir. 2005); *C.E. Carlson v. SEC*, 859 F.2d 1429, 1435 (10th Cir. 1988); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007) (noting that "[e]very Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly" but that standards vary). "Extreme recklessness is an 'extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'" *Rockies Fund*, 428 F.3d at 1093 (quoting *SEC v. Steadman*, 967 F.2d 636, 641 (D.C. Cir. 1992)); *accord C .E. Carlson*, 859 F.2d at 1435.

35 *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 152 (1972) (finding it irrelevant that the defendants "may have *made* no positive representation" because only Rule 10b-5(b) "specifies the making of an untrue statement of a material fact") (emphasis added).

36 *SEC v. Clark*, 915 F.2d 439, 448 (9th Cir. 1990) (noting the breadth of the terms "'fraud,' 'deceit,' and 'device, scheme, or artifice'").

37 *Collins Sec. Corp.*, 46 SEC 20, 33 (1975) (internal quotation marks omitted).

38 *Affiliated Ute*, 406 U.S. at 151.

39 *See, e.g., Santa Fe*, 430 U.S. at 475-76.

40 *United States v. O'Hagan*, 521 U.S. 642, 651 (1997).

41 *Santa Fe*, 430 U.S. at 473.

plaintiff "may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of Section 10(b)," only conduct that is itself manipulative or deceptive violates Rule 10b-5.[42]

In our view, therefore, primary liability under Rule 10b-5(a) and (c) extends to anyone who (with scienter, and in connection with the purchase or sale of securities) employs *any* manipulative or deceptive device, scheme, or artifice to defraud or engages in *any* manipulative or deceptive act, practice, or course of business that operates as a fraud. In particular, as discussed above, we understand the statutory term "deceptive" to connote a broad proscription against conduct that deceives or misleads another, and nothing in the text, history, or our prior interpretations of the rule suggest that subsections (a) and (c) in any way limit that understanding.

Thus, the courts to consider the issue agree, as do we, that the prohibitions in subsections (a) and (c) encompass the falsification of financial records to misstate a company's performance.[43] Those prohibitions also encompass the orchestration of sham transactions designed to give the false appearance of business operations.[44] But contrary to the view expressed by some courts that Rule 10b-5(a) and (c) are limited to conduct "beyond mere misstatements and omissions,"[45] we conclude that subsections (a) and (c) also proscribe making, drafting, or devising a material misstatement. Furthermore, because nondisclosure in violation of a fiduciary duty involves "feigning fidelity" to the person to whom the duty is owed and is therefore deceptive,[46] we find that failing to correct a material misstatement in violation of a fiduciary duty to do so also falls within the prohibitions of Rule 10b-5(a) and (c).

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[42] *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173, 177-78 (1994); *accord Robert W. Armstrong, III*, Exchange Act Release No. 51920, 58 SEC 542, 2005 WL 1498425, at *6 (June 24, 2005); *Leslie A. Arouh*, Exchange Act Release No. 50889, 57 SEC 1099, 2004 WL 2964652, at *5 (Dec. 20, 2004).

[43] *E.g.*, *Monterosso*, 756 F.3d at 1334-36 (holding that falsification of financial records can suffice for primary liability under Rule 10b-5(a)); *SEC v. Familant*, 910 F. Supp. 2d 83, 86-88, 93-97 (D.D.C. 2012) (agreeing that such conduct suffices for primary liability under both Rule 10b-5(a) and (c)); *Langford*, 2013 WL 1943484, at *8 (same); *Sells*, 2012 WL 3242551, at *6-7 (same); *Mercury Interactive*, 2011 WL 5871020, at *2 (same).

[44] *E.g.*, *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 504 (S.D.N.Y. 2005) (holding that banks could be liable under Rule 10b-5(a) and (c) for engaging in transactions with issuer that lacked economic substance and allowed the issuer to misstate its financial condition); *In re Global Crossing Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 336-37 (S.D.N.Y. 2004) (holding that auditor could be liable under Rule 10b-5(a) and (c) for masterminding sham swap transactions that were used to circumvent GAAP and inflate and misstate company's revenue); *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 173-74 (D. Mass. 2003) (holding that companies that created and financed sham entities that entered into bogus transactions with another company to inflate and misstate that company's profits could be liable under Rule 10b-5(a) and (c)).

[45] *E.g.*, *Familant*, 910 F. Supp. 2d at 97.

[46] *See O'Hagan*, 521 U.S. at 655.

These actions, in our view, constitute employing a deceptive "device" or engaging in a deceptive "act."[47] Indeed, the Supreme Court recently indicated that it agreed with this understanding—at least with regard to Rule 10b-5(a) encompassing the "making" of a material misrepresentation or a similar omission.[48] And, Section 10(b) and Rule 10b-5 "are not intended as a specification of particular acts or practices that constitute 'manipulative or deceptive devices or contrivances,' but are instead designed to encompass the infinite variety of devices that are alien to the 'climate of fair dealing.'"[49]

In sum, primary liability under Rule 10b-5(a) and (c) extends to any defendant whose "challenged conduct in relation to a fraudulent scheme constitutes the use of a deceptive device or contrivance," even if a misstatement "made" by another person for purposes of Rule 10b-5(b) "creates the nexus between the scheme and the securities markets."[50] A defendant who employs a deceptive device or engages in a deceptive act cannot escape primary liability under Rule 10b-5(a) and (c) by arguing that his deceptive device or act involved misstatements and another person "made" the misstatements for purposes of Rule 10b-5 as construed by *Janus*.[51]

c. Primary liability under Rule 10b-5(a) and (c) is not limited to deceptive conduct "beyond" misstatements or omissions.

Given our reading of Section 10(b) and Rule 10b-5(a) and (c), we necessarily disagree that a "defendant may only be liable as part of a fraudulent scheme based upon misrepresentations and omissions under Rule 10b-5(a) or (c) when the scheme also encompasses conduct *beyond* those misrepresentations or omissions."[52] Such a conclusion contravenes the plain text of the rule. Rule 10b-5(a) proscribes deceptive "device[s]," "scheme[s]," and

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47 17 C.F.R. § 240.10b-5(a), (c).

48 *Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058, 1063 (2014) (stating that Rule 10b-5 "forbids the use of any 'device, scheme, or artifice to defraud' (*including* the making of 'any untrue statement of a material fact' or any similar 'omi[ssion]') 'in connection with the purchase or sale of any security'" (alterations in original; emphasis added)).

49 *United States v. Charnay*, 537 F.2d 341, 349 (9th Cir. 1976) (citation omitted).

50 *Parmalat*, 376 F. Supp. 2d at 502-03 (citing *Lernout & Hauspie*, 236 F. Supp. 2d at 173-74).

51 *See SEC v. Strebinger*, 114 F. Supp. 3d 1321, 1329-1331 (N.D. Ga. 2015) (despite defendant's argument that the Commission "fail[ed] to allege that [he] *made* the misstatements within the" reports, finding sufficient for liability under Rule 10b-5(a) and (c) the allegations that defendant "contributed to the contents" of reports that contained misstatements, "edited, and otherwise provided information for," the reports that contained misstatements, and "arrange[d] the dissemination of the" reports knowing that they contained misstatements).

52 *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057-58 (9th Cir. 2011) (emphasis added) (collecting cases); *accord Public Pension Fund Grp. v. KV Pharm. Co.*, 679 F.3d 972, 987 (8th Cir. 2012) (following *WPP Luxembourg*); *see also Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177-78 (2d Cir. 2005) (applying similar rule).

"artifice[s] to defraud," and Rule 10b-5(c) proscribes, among other things, deceptive "act[s]." It would be arbitrary to read those terms as *excluding* the making, drafting, or devising of a misstatement or omission.[53] And, as noted, the Supreme Court has recently indicated that it would reject such a narrow reading of subsections (a) and (c).[54]

The three subsections of Rule 10b-5 need not be read exclusively, such that conduct that falls within the purview of one—*e.g.*, misstatements or omissions, within subsection (b)—cannot also fall within another. To the contrary, we have advised that the subsections of the rule are "mutually supporting rather than mutually exclusive."[55] Reading the subsections of Rule 10b-5 to overlap ensures that investors are appropriately protected from manipulative or deceptive conduct in connection with the purchase or sale of securities.

In addition, the "beyond a misstatement" formulation has arisen from a misunderstanding of the Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver*.[56] In *Central Bank*, the Court explained that only defendants who themselves employ a manipulative or deceptive device or make a material misstatement may be primarily liable under Rule 10b-5; others are, at most, secondarily liable as aiders and abettors and "a private plaintiff may not maintain an aiding and abetting suit under Section 10(b)."[57] The Court found that the defendant bank could not be primarily liable merely for having facilitated the fraudulent scheme

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53 If a deceptive device that is "beyond" a misstatement suffices for liability, then a deceptive device that is not "beyond" a misstatement also should suffice. Falsifying an invoice as part of a fraud involving revenue misstatements has been considered a deceptive device "beyond" the misstatements. *See, e.g.*, *Familant*, 910 F. Supp. 2d at 92-93, 97. The conversion of those false invoices into a misstatement about revenue—*i.e.*, drafting the misstatement—also should be viewed as a deceptive device. The latter is no less deceptive than the former. For purposes of primary liability, it should not matter whether the deceptive act could be considered "beyond the misstatement."

54 *See Troice*, 134 S. Ct. at 1063.

55 *Cady, Roberts & Co.*, 1961 WL 60638, at *4. And in *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 197-98 (1963), the Supreme Court explained that because the Securities Act of 1933 was "the first experiment in federal regulation of the securities industry," it "was understandable" that Congress "include[d] both a general proscription against fraudulent and deceptive practices and, out of an abundance of caution, a specific proscription against nondisclosure." Because Rule 10b-5 was modeled on Section 17(a) of the Securities Act, we find the same logic applicable to Rule 10b-5. It is thus reasonable to construe Rule l0b-5(a) and (c) as encompassing "all acts within the purview of Rule 10b-5[(b)]." *See* Arnold S. Jacobs, *Disclosure and Remedies under the Securities Laws* § 6:22 (citing *Capital Gains*); *accord* 1 Alan R. Bromberg et al., *Bromberg & Lowenfels on Securities Fraud* § 2:181 (2d ed.); *see also Troice*, 134 S. Ct. at 1063.

56 511 U.S. 164.

57 *Id.* at 191.

by agreeing to delay an appraisal.[58] Lower courts have appropriately read *Central Bank* to require that, in cases involving fraudulent misstatements, defendants cannot be primarily liable under Rule 10b-5(a) or (c) merely for having "assisted" an alleged scheme to make a fraudulent misstatement (without engaging in conduct that is manipulative or deceptive).[59] But some courts have articulated this "more than mere assistance" standard imprecisely, stating that primary liability under Rule 10b-5(a) and (c) must require proof not just of manipulative or deceptive conduct, but of particular deceptive conduct "beyond" the alleged misstatements.[60]

This construction of our rule is neither consistent with nor dictated by *Central Bank*. *Central Bank* does not hold that primary liability under Rule 10b-5(a) and (c) turns on whether a defendant's conduct is "beyond" a misstatement. Instead, *Central Bank* stands for the proposition that any defendant whose conduct is manipulative or deceptive may be liable as a primary violator under Rule 10b-5.[61]

Additionally, *Janus* does not independently justify such a test.[62] In *Janus*, the Court construed only the term "make" in Rule 10b-5(b), which does not appear in subsections (a) and

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[58] *Id.* at 168-69, 191.

[59] *E.g., Great Neck Capital Appreciation Inv. P'ship, L.P. v. Pricewaterhouse Coopers, L.L.P.*, 137 F. Supp. 2d 1114, 1121 (E.D. Wis. 2001) (finding allegations that accounting firm "assisted with the press release by reviewing it and advising [company] that it conformed to GAAP" insufficient to support primary liability because plaintiffs did not allege that accounting firm "drafted the release, publicly adopted it, or allowed its name to be associated with it").

[60] *E.g., In re Alstom SA*, 406 F. Supp. 2d 433, 475-76 (S.D.N.Y. 2005).

[61] 511 U.S. at 177-78, 191. We believe our approach appropriately distinguishes between primary and secondary liability, as *Central Bank* requires. Defendants who merely obtain or transmit legitimate documents knowing that they would later be falsified in order to misstate a company's financial condition would not be primarily liable under Rule 10b-5(a) and (c), but could be liable for aiding and abetting. Similarly, defendants who engage in legitimate, rather than sham, transactions generally would not be primarily liable under Rule 10b-5(a) and (c), even if they "knew or intended that another party would manipulate the transaction to effectuate a fraud." *See, e.g., Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1047-50 (9th Cir. 2006), *vacated on other grounds sub nom. Avis Budget Group, Inc. v. Cal. Stat Teachers' Ret. Sys.*, 552 U.S. 1162 (2008). And defendants who have no fiduciary duty of disclosure but who are aware of a fraud and have the potential to benefit from it but take no action to stop it also would be aiders and abettors of a Rule 10b-5 violation rather than primary violators themselves. *See SEC v. Aragon Cap. Advisors, LLC*, 2011 WL 3278907, at *17-18 (S.D.N.Y. July 26, 2011) (finding that defendants who were aware that their brother was trading based on material non-public information in accounts in their names aided and abetted the fraud by their inaction because they stood to benefit from the fraud and thus their inaction was intentionally designed to aid the fraud). In these situations, the defendants are aiders and abettors rather than primary violators because their own conduct was not deceptive.

[62] *See, e.g., Monterosso*, 756 F.3d at 1334 (stating that "*Janus* only discussed what it means to 'make' a statement for purposes of Rule 10b–5(b), and did not concern . . . Rule 10b–5(a) or (c)"); Jacobs, *Disclosure and Remedies under the Securities Laws* § 12:113.99 (agreeing that

(continued…)

(c); the decision did not mention or construe the broader text of those provisions.[63] The Court did not suggest that because the "maker" of a false statement is primarily liable under subsection (b), that person cannot *also* be liable under subsections (a) and (c). Nor did the Court indicate that a defendant's failure to "make" a misstatement for purposes of subsection (b) precludes primary liability under the other provisions. *Janus* thus provides no support for the notion that primary liability under those provisions is limited to deceptive acts "beyond" misstatements.[64]

Indeed, our view of primary liability under Rule 10b-5(a) and (c) is consistent with the rationales on which *Janus* rests. The Court first emphasized the textual basis for its holding, concluding that one who merely "prepares" a statement necessarily is not its "maker," just as a mere speechwriter lacks "ultimate authority" over the contents of a speech.[65] Our approach does not conflict with that logic: Accepting that a drafter, for example, may not be primarily liable under Rule 10b-5*(b)* if he did not "make" the misstatement, our position is that the drafter instead could be primarily liable under subsections *(a)* and *(c)* for employing a deceptive "device" and engaging in a deceptive "act." At least one court of appeals has agreed with that view.[66] Indeed, this textual reading of Rule 10b-5(a) and (c) is consistent with the *Janus* Court's own emphasis on adhering to the text of the rule.[67]

Our approach is also consistent with the second rationale in *Janus*—that a drafter's, as opposed to a "maker's," conduct is too remote to satisfy the element of reliance in private actions

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(…continued)
Janus "does not control any suit under" Rule 10b-5(a) or (c)). *But see, e.g., SEC v. Benger*, No. 09 C 676, 2013 WL 1150587, at *5 (N.D. Ill. Mar. 21, 2013) ("*Janus* cannot be skirted simply by artful pleading and rechristening a 10b-5(b) claim as a claim under 10b-5(a) and (c).").

63 *See generally Janus*, 131 S. Ct. 2296.

64 As we reject the "beyond a misstatement" approach, we necessarily also reject the reading of Rule 10b-5(a) and (c) adopted in *Kelly*, 817 F. Supp. 2d at 344. *See supra* note 13. There, the court concluded that, in any case involving misstatements, *Janus* precludes primary liability under Rule 10b-5(a) and (c) for all defendants who do not themselves "make" the misstatements, regardless of whether they engaged in deceptive conduct "beyond" the misstatements. That reading of *Janus* mistakenly assumes both that the Court intended to construe provisions that it never mentioned and that the Court intended to give primacy to Rule 10b-5(b) at the expense of subsections (a) and (c). Indeed, as one court observed, "*Kelly* cast subsection (b) in Rule 10b-5's lead role and then crippled subsections (a) and (c) to ensure that they would never overshadow the star." *Familant*, 910 F. Supp. 2d at 95. A number of district court have disagreed with *Kelly*'s reading of *Janus*. *E.g., Strebinger*, 114 F. Supp. 3d. at 1331 n.9; *Sells*, 2012 WL 3242551, at *6-7; *Langford*, 2013 WL 1943484, at *8; *Garber*, 2013 WL 1732571, at *4; *SEC v. Geswein*, 2011 WL 4541308, at *17 n.3 (N.D. Ohio Aug. 2, 2011), *adopted in relevant part*, 2011 WL 4565861 (N.D. Ohio Sept. 29, 2011).

65 *Janus*, 131 S. Ct. at 2302.

66 *Big Apple Consulting*, 783 F.3d at 796.

67 *Janus*, 131 S. Ct. at 2302-04.

arising under Rule 10b-5. Investors, the Court explained, cannot be said to have relied on "undisclosed act[s]," such as drafting a misstatement, that "preced[e] the decision of an independent entity to make a public statement."[68] Again, our analysis fully comports with that logic. Indeed, as *Janus* recognizes, if the private plaintiffs' claims in *Janus* had arisen under Rule 10b-5(a) or (c), those plaintiffs may not have been able to show reliance on the drafters' conduct. Thus, our interpretation does not expand the "narrow scope" the Supreme Court "give[s to] the implied private right of action."[69] In contrast to private parties, however, the Commission need not show reliance as an element of its claims.[70] Thus, even if *Janus* precludes liability in private actions for those who commit "undisclosed" deceptive acts, it does not preclude liability in Commission enforcement actions under Rule 10b-5(a) and (c) against those same individuals.

2. Primary Liability Under Sections 17(a)(1) and (a)(3) of the Securities Act

a. Section 17(a) does not require conduct that is itself manipulative or deceptive.

Section 17(a) of the Securities Act makes it unlawful, in the offer or sale of any security, "(1) to employ any device, scheme, or artifice to defraud"; (2) "to obtain money or property by means of any untrue statement of a material fact or any [material] omission"; or (3) "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."[71] Absent from these provisions is the language of Section 10(b) requiring that the proscribed conduct be "manipulative or deceptive."[72] There is therefore no textual basis for concluding that Rule 10b-5's requirement that the defendant's violative conduct itself be "manipulative or deceptive" also applies to Section 17(a).[73]

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68 *Id.* at 2303-04 (citing *Stoneridge Inv. Partners v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 161 (2008)).

69 *Id.* at 2303.

70 *See, e.g., SEC v. Morgan Keegan & Co.*, 678 F.3d 1233, 1244 (11th Cir. 2012) (noting that reliance is not an element of a Commission enforcement action).

71 15 U.S.C. § 77q(a).

72 *See id.* § 78j(b).

73 Some commenters have recognized that Section 17(a) may cover conduct that is not itself manipulative or deceptive because it does not contain the language of Section 10(b). *E.g.*, 4 Thomas Lee Hazen, *Treatise on the Law of Securities Regulation* § 12.22 ("Section 17(a) does not contain the phrase 'manipulative or deceptive device' that is found in Section 10(b) of the Exchange Act and has formed a basis of the scienter and deception requirements."); Donald C. Langevoort, *Fraud and Deception by Securities Professionals*, 61 Tex. L. Rev. 1247, 1293 (1983) ("Aside from [S]ection 10(b), [S]ection 17(a) of the Securities Act of 1933 is the broadest section prohibiting fraud 'in the offer or sale' of any security. It is not limited to deception or manipulation . . . ."). Nevertheless, some courts have, without meaningful analysis, described Section 17(a)'s proscriptions as "substantially identical" to those in Rule 10b-5. *E.g.*, *Landry v. All Am. Assurance Co.*, 688 F.2d 381, 386 (5th Cir. 1982).

As the Court explained in *Aaron*, Section 17(a)(1) requires a showing of scienter, or deceptive *intent*,[74] but we find that mental-state requirement distinct from the need to show, under Exchange Act Section 10(b), that the defendant's violative conduct is itself deceptive (or manipulative).[75] Moreover, reading Section 17(a) not to impose such a requirement ensures that investors are appropriately protected from conduct in the offer or sale of securities that is not itself manipulative or deceptive—but nevertheless would operate as a fraud on those investors.

b. Section 17(a)(1), like Rule 10b-5(a) and (c), encompasses fraudulent conduct involving misstatements.

Like Rule 10b-5(a) and (c), we read the language of Section 17(a)(1) to encompass all fraudulent conduct undertaken with scienter—including conduct undertaken as part of a fraud involving misstatements.[76] Indeed, Section 17(a)(1) is identical to Rule 10b-5(a) in prohibiting the "employ[ment]" of a "device," "scheme," or "artifice to defraud."[77] And, as explained above, a misstatement or omission of a material fact is undoubtedly a "device" or "artifice" to defraud.[78]

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[74] *Aaron v. SEC*, 446 U.S. 680, 695-697 (1980). A showing of negligence suffices under subsections (a)(2) and (a)(3). *Id.* at 697. Negligence requires a showing that the defendant failed to exercise reasonable care. *Ira Weiss*, Exchange Act Release No. 52875, 58 SEC 977, 2005 WL 3273381, at *12 (Dec. 2, 2005) (citing *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3d Cir. 1997)), *pet. denied, Weiss v. SEC*, 468 F.3d 849 (D.C. Cir. 2006). The Supreme Court in *Aaron* makes clear that negligence is sufficient for liability under Sections 17(a)(2) and (a)(3), *e.g.*, *SEC v. Smart*, 678 F.3d 850, 857 (10th Cir. 2012); *Weiss*, 468 F.3d at 855, though the Court has never addressed whether negligence is *necessary* to prove a violation of those provisions. *See Aaron*, 446 U.S. at 696-97 (noting that the focus of Section 17(a)(3), at least, is on the "*effect* of particular conduct on members of the investing public, rather than upon the culpability of the person responsible" for the conduct"); *see also United States v. Tagliaferri*, __ F.3d __, 2016 WL 2342677, at *5 (2d Cir. May 4, 2016) (relying on this language from *Aaron*).

[75] *Accord Klamberg v. Roth*, 473 F. Supp. 544, 556 (S.D.N.Y. 1979) (noting that because Section 17(a) "is in many respects broader than [S]ection 10(b)," the Section 17(a) claims could survive even absent deceptive conduct by the defendant himself). We can conceive of a number of ways that a defendant might contribute to a fraud through conduct that is not itself deceptive or manipulative. For example, if a defendant company executed legitimate transactions with another entity knowing that the other entity would use the transactions to misstate its revenue, the defendant company would not be liable under Section 10(b) because the transactions were not themselves deceptive, but would still be liable under Section 17(a). *See, e.g.*, *Simpson*, 452 F.3d at 1050.

[76] In our analysis of Sections 17(a)(1) and (a)(3), we find irrelevant the case law requiring conduct "beyond" a misstatement for claims arising under Rule 10b-5(a) and (c). As discussed above, that authority is unpersuasive even in the context of Rule 10b-5(a) and (c). And, in any case, those cases only involve Section 10(b) and Rule 10b-5, not Section 17(a).

[77] 15 U.S.C. § 77q(a)(1).

[78] *See Troice*, 134 S. Ct. at 1063.

Thus, one who (with scienter) makes a material misstatement or omission of a material fact in the offer or sale of a security has violated Section 17(a)(1) because such conduct constitutes "employ[ing]" a "device, scheme, or artifice to defraud." Futhermore, anyone (acting with scienter) who, for example, drafts or devises a misstatement of a material fact, uses a misstatement of a material fact made by others to defraud investors, or fails to correct a misstatement of a material fact despite a fiduciary duty to do so likewise has "employ[ed]" a "device" or "artifice to defraud" and therefore, violated Section 17(a)(1).[79]

We thus reject any suggestion that the reach of Section 17(a)(1) is limited because Section 17(a)(2) expressly prohibits certain negligent misstatements.[80] Section 17(a)(1) and (a)(2) address very different types of conduct—Section 17(a)(1) proscribes all scienter-based fraud, whereas Section 17(a)(2) prohibits negligent misrepresentations that deprive investors of money or property. And we have recognized that the subsections of Section 17(a) are "mutually supporting rather than mutually exclusive."[81] As the Supreme Court has observed, "[e]ach succeeding prohibition [in Section 17(a)] is meant to cover additional kinds of illegalities—not to narrow the reach of the prior sections."[82] Reading the provisions as mutually exclusive could

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[79] *See, e.g.*, *Big Apple Consulting*, 798 F.3d at 792, 795-798 (upholding jury verdict finding defendants liable for violating Sections 17(a)(1), (2), and (3) where they, among other things, "conceived, drafted, edited, or reviewed numerous press releases" containing materially misleading statements); *Monterosso*, 756 F.3d at 1334 (holding that falsification of financial records can be sufficient for liability under Section 17(a)(1)); *Strebinger*, 114 F. Supp. 3d at 1332 (finding allegations that defendant "contributed to the contents" of reports that contained misstatements, "edited, and otherwise provided information for," the reports, and "arrange[d] the dissemination of the" reports knowing that they contained misstatements sufficient for liability under Section 17(a)(1)-(3)). *See generally United States v. Naftalin*, 441 U.S. 768, 772 (1979) (recognizing that a defendant who "falsely represented that he owned the stock he sold" violated Section 17(a)(1)).

[80] *See, e.g.*, *Kelly*, 817 F. Supp. 2d at 345-46. Nothing in *Janus* is inconsistent with our understanding of Section 17(a)(1). Nearly all courts to consider the issue agree that *Janus* has no bearing on Section 17(a). *E.g.*, *Big Apple Consulting*, 783 F.3d at 798 (stating that Sections 17(a)(1) and (a)(3) "are in no way directly or indirectly affected by the *Janus* decision"); *Monterosso*, 756 F.3d at 1334 (stating that *Janus* addressed only "what it means to 'make' a statement for purposes of Rule 10b–5(b), and did not concern 17(a)(1) or (3)"); *Sentinel Mgmt. Group*, 2012 WL 1079961, at *14-15; *Stoker*, 865 F. Supp. 2d at 465-66 (collecting cases); *Sells*, 2012 WL 3242551, at *7 (collecting cases); 5 *Bromberg & Lowenfels on Securities Fraud* § 7:306.58 (collecting cases); *see also Disclosure and Remedies under the Securities Laws* § 12:113.99 (concurring that *Janus* does not affect the scope of liability under Section 17(a)).

[81] *Cady, Roberts & Co.*, 1961 WL 60638, at *4.

[82] *Naftalin*, 441 U.S. at 774. Reading Section 17(a)(1) to encompass misstatements does not cause Section 17(a)(2) to be wholly subsumed by Section 17(a)(1), because Section 17(a)(2) permits liability for negligence, whereas Section 17(a)(1) requires a showing of scienter. *See Aaron*, 446 U.S. at 695-97.

also limit our ability to protect investors from fraudulent misstatements in the offer or sale of securities where the misstatements did not involve obtaining money or property.

c. Section 17(a)(3) encompasses fraudulent conduct involving misstatements to the extent the fraudulent conduct can be considered a transaction, practice, or course of business.

Section 17(a)(3) prohibits all "transaction[s]," "practice[s]," and "course[s] of business" that "operate[] or would operate as a fraud."[83] Although this language closely resembles Rule 10b-5(c), Section 17(a)(3) uses the term "transaction" rather than the broader term "act." For purposes of determining whether misstatement-related conduct comes within the purview of Section 17(a)(3), we find that difference significant: While a misstatement or omission (or related activity) may fairly be characterized as an "act," a misstatement or omission is not a "transaction."[84] As a result, whereas Rule 10b-5(a) and (c) and Section 17(a)(1) all proscribe even a single act of, for example, making or drafting a materially misleading statement to investors, Section 17(a)(3) would not proscribe a single act unless that single act may be considered a "transaction," "practice," or "course of business." That said, *repeated* acts, such as repeatedly making or drafting materially misleading statements over a period of time, may be considered a fraudulent "practice" or "course of business."[85] Accordingly, we read Section 17(a)(3) to be narrower than Rule 10b-5(c) in this respect—*i.e.*, Section 17(a)(3) does not encompass those "acts" proscribed by Rule 10b-5(c) that are not "transactions," "practices" or "courses of business."[86]

Despite being narrower than Rule 10b-5(c) in some respects, Section 17(a)(3) is broader than Rule 10b-5(c) (and Section 17(a)(1)) in others. As discussed above, unlike Rule 10b-5(c), Section 17(a)(3) does not require that the defendant have engaged in conduct that is itself deceptive (or manipulative). Nor does Section 17(a)(3) require a showing of scienter. *Aaron* instructs that "the language of [Section] 17(a)(3)] . . . quite plainly focuses upon the effect of particular conduct on members of the investing public, rather than upon the culpability of the

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83 15 U.S.C. § 77q(a)(3).

84 *Compare* Webster's New International Dictionary 25 (def. 1) (2d ed. 1934) (defining "act" broadly as "[t]hat which is done or doing; the exercise of power, or the effect whose cause is power exerted; a performance; a deed") *with id.* 2688 (def. 2a) (defining "transaction" as "[a] business deal; an act involving buying and selling").

85 *See id.* at 1937 (def. 1b) (defining "practice," when used as a noun, in terms suggesting repeated conduct engaged in over time: "often, repeated or customary action; usage; habit; custom; . . . the usual mode or method of doing something"); *id.* 610 (def. 5) (defining "course," when used in phrases like "course of conduct," to mean "a succession of acts or practices" or "[a] series of motions or acts"). We note that "transaction" is also an operative term in the statute—a transaction, such as a trade, that itself operated or would operate as a fraud could serve as the basis for primary liability, as well.

86 *See* Jacobs, *Disclosure and Remedies under the Securities Laws* § 3:248 (suggesting that "the word 'transaction' in Section [17(a)(3)] is less broad than 'act' in [Rule 10b-5(c)]").

person responsible."[87] Section 17(a)(3)'s prohibition thus applies, for example, where, as a result of a defendant's negligent conduct, investors receive misleading information about the nature of an investment or an issuer's financial condition. It also applies, for example, where, as a result of a defendant's negligent conduct, prospective investors are prevented from learning material information about a securities offering.[88] This reading of the statute ensures that investors are protected from potentially harmful courses of conduct in the offer and sale of securities.

3. Primary liability under Section 206 of the Advisers Act.

Section 206(1) of the Advisers Act makes it unlawful for "any investment adviser" to "employ any device, scheme, or artifice to defraud any client or prospective client."[89] Section 206(2) makes it unlawful for the investment adviser to "engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."[90] Scienter is required to establish a violation of Advisers Act Section 206(1); a showing of negligence is sufficient for a violation of Section 206(2).[91] As is true of Exchange Act Rule 10b-5(a) and (c) and Securities Act Sections 17(a)(1) and (3), Sections 206(1) and 206(2) "lack any reference to *making* statements."[92] As a result, investment advisers may be held primarily liable under these provisions for their fraudulent conduct regardless of whether they "made" misstatements.[93]

These proscriptions apply to "any investment adviser."[94] Section 202(a)(11) defines an investment adviser as "any person who, for compensation, engages in the business of advising

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87 *Aaron*, 446 U.S. at 697 (emphasis omitted); *accord Tagliaferri*, 2016 WL 2342677, at *5.

88 *See, e.g.*, *Weiss v. SEC*, 468 F.3d 849, 855 (D.C. Cir. 2006) (denying petition for review where Commission found a school district's bond counsel liable under Section 17(a)(3) for having "fail[ed] to look for even minimal objective "support for school district's statements in bond prospectus when approving prospectus and issuing opinion letters); *Johnny Clifton*, Securities Act Release No. 9417, 2013 WL 3487076, at *10 (July 12, 2013) (finding a Section 17(a)(3) violation because defendant "conceal[ed] material adverse information" from "sales representatives" and "ensure[d] that sales representatives who learned such information also withheld it from prospective investors"); *see also Byron G. Borgardt*, 56 S.E.C. 999, 2003 WL 22016313, at *13 (Aug. 25, 2003) (finding respondents liable under Section 17(a)(3) for failing to provide appropriate disclosures in registration statements).

89 15 U.S.C. 80b-6(1).

90 15 U.S.C. 80b-6(2).

91 *SEC v. Washington Inv. Network*, 475 F.3d 392, 396-397 (D.C. Cir. 2007) (citing *SEC v. Steadman*, 967 F.2d 636, 641, 643 (D.C. Cir. 1992) (quoting *Hochfelder*, 425 U.S. at 194 n.12)).

92 *Donald L. Koch*, Advisers Act Release No. 3836, 2014 WL 1998524, at *18 (May 16, 2014) (emphasis added), *aff'd*, 793 F.3d 147 (D.C. Cir. 2015).

93 *Id.*

94 15 U.S.C. 80b-6(1), (2).

others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities."[95] This definition "does not include whether one is registered or not with the SEC."[96] An individual may be primarily liable under the Section 206(1) and (2), therefore, irrespective of registration with the Commission."[97] Accordingly, anyone whose activities "fall[] under the broad definition of 'investment adviser' in the Act" may be "liable as a primary violator under Advisers Act Sections 206(1) and 206(2)."[98]

Primary liability for a violation of Rule 206(4)-1 under the Advisers Act, which implements Section 206(4), is narrower in scope. Section 206(4) provides that it shall be unlawful for an investment adviser "to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative," and that the Commission shall, for purposes of this section, define "such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative."[99] Rule 206(4)-1 provides in turn that certain conduct "shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act for any investment adviser *registered or required to be registered* under section 203 of the Act."[100]

B. Malouf Violated Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, Section 17(a) of the Securities Act, and Section 206 of the Advisers Act.

We find that Malouf violated Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5(a) and (c), Sections 17(a)(1) and 17(a)(3) of the Securities Act, and Sections 206(1) and 206(2) of the Advisers Act. Although Malouf may not have "made" the material misstatements in UASNM's Forms ADV and on its website regarding UASNM's independence, he failed to correct those misstatements despite having a fiduciary duty to do so, and he acted with scienter.[101] As discussed below, we conclude that through his misconduct Malouf employed a deceptive device and artifice to defraud, and he engaged in a deceptive act, practice, and course of business that operated as a fraud in violation of those provisions.[102] We also find that Malouf

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95 15 U.S.C. 80b-2(a)(11).

96 *Koch v. SEC*, 793 F.3d 147, 157 (D.C. Cir. 2015).

97 *Id.*

98 *Koch*, 2014 WL 1998524, at *18 (citing 15 U.S.C. 80b-2(a)(11) and collecting cases).

99 15 U.S.C. 80b-6(4).

100 17 C.F.R. 15 U.S.C. § 275.206(4)-1 (emphasis added). *See infra* Part II.B.5.

101 From the record, it is clear that Malouf was, as he himself described his role, the "top dog" at UASNM and he admitted he was at least "partially responsible" for its disclosures in its Forms ADV and on its website. This evidence might support a finding that Malouf had "ultimate authority" over those statements for purposes of assessing liability under Rule 10b-5(b); however, we do not reach the issue since Malouf was not charged under that provision.

102 It is undisputed that the highly liquid, AAA-rated Treasury and agency bonds that UASNM's clients purchased through RJ between 2008 and 2011 were securities, that Malouf used instrumentalities of interstate commerce to offer and sell them, and that the statements in

(continued…)

violated Sections 206(1) and 206(2) of the Advisers Act by failing to seek best execution for his clients. Finally, we find that Malouf aided and abetted UASNM's violations of the Advisers Act.

1. Malouf violated Exchange Act Section 10(b) and Rule 10b-5(a) and (c) by failing to correct the material misstatements on UASNM's Forms ADV and website.

a. Malouf employed a deceptive device and artifice to defraud and engaged in a deceptive act, practice, and course of business by failing to correct the material misstatements in UASNM's Forms ADV and on its website in violation of his fiduciary duty to do so.

UASNM's Forms ADV and website contained numerous material misstatements:

- UASNM's Forms ADV from 2008 to 2011 represented that UASNM's selection of an executing broker was not based "upon any arrangement between the recommended broker and UAS[NM.]"

- UASNM's April 2010 Form ADV also stated that "employees of UASNM are not registered representatives of … RJ … and do not receive any commissions or fees from recommending these services."

- UASNM's website claimed that UASNM provided impartial investment advice, that its brokerage recommendations were not "based upon any arrangement between the recommended broker and UASNM" and that UASNM "vigorously maintain[s its] independence" and that its advice was "void of conflicts of interest."

In none of these communications did UASNM disclose that in fact Malouf had an arrangement with Lamonde whereby Lamonde paid him an amount equal (or almost equal) to the commissions that Lamonde received on the trades Malouf directed to Lamonde's RJ branch.

Malouf acknowledged that, as UASNM's CEO, he was at least "partially responsible" for UASNM's Forms ADV and website. He also admitted that he reviewed some of the Forms ADV between 2008 and 2011, "focusing on disclosures relating to himself and [the RJ branch]." Malouf also admitted "[w]hile he may not have read every word of UASNM's website, he was familiar with its contents in the 2008, 2009, and 2010 time frame" and that he "probably read" the statements on the website in 2008 to the effect that UASNM provided independent advice and had no arrangements with broker-dealers.

(…continued)
the Forms ADV and on UASNM's website were made in connection with offers and sales of securities. We thus find by a preponderance of the evidence that these elements of the charged violations are satisfied.

We find that Malouf acted deceptively in failing to correct the misstatements noted above. As an investment adviser, Malouf had a fiduciary obligation to provide "'full and fair disclosure of all material facts,'"[103] as well as an "affirmative obligation to avoid misleading [his] clients."[104] He also had "a duty to disclose any potential conflicts of interest accurately and completely."[105] Separately, Malouf acknowledged that his agreement with Lamonde created a conflict of interest: He had an incentive to send UASNM clients' bond transactions to RJ so that Lamonde would be able to pay Malouf the amounts he owed him for the branch ($1,068,084). By failing to correct UASNM's multiple representations that he did *not* have a conflict, Malouf breached his fiduciary duties as an investment adviser. Because it is well established that "nondisclosure in breach of a fiduciary duty 'satisfies section 10(b)'s requirement . . . [of] a 'deceptive device or contrivance,'"[106] we find that Malouf acted deceptively.[107]

Having found that Malouf acted deceptively, we also find that he employed a device and artifice to defraud in violation of Rule 10b-5(a) and engaged in an act, practice, and course of business that operated as a fraud in violation of Rule 10b-5(c). Malouf's failure to correct the misstatements on UASNM's website and in its Forms ADV left clients with the false impression that UASNM received no commissions from its brokerage recommendations, provided independent and impartial investment advice, and had no arrangements with broker-dealers. Several of UASNM's clients testified that they would have wanted to know about Malouf's potential conflict, confirming that the information was material to their decision to select UASNM as an investment adviser. Because Malouf's conduct deprived his clients of this

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[103] *Geman v. SEC*, 334 F.3d 1183, 1189 (10th Cir. 2003) (quoting *Capital Gains*, 375 U.S. at 194); *accord SEC v. DiBella*, 587 F.3d 553, 563 (2d Cir. 2009).

[104] *SEC v. Washington Inv. Network*, 475 F.3d 392, 395 (D.C. Cir. 2007) (quoting *Capital Gains*, 375 U.S. at 194); *accord SEC v. Blavin*, 760 F.2d 706, 711-712 (6th Cir. 1985); see also *DiBella*, 587 F.3d at 568 ("The 'legislative history [of the Advisers Act] leaves no doubt that Congress intended to impose enforceable fiduciary obligations' on investment advisers."). An associated person of an investment adviser is also a fiduciary. *See, e.g.*, *Christopher A. Lowry*, Investment Advisers Act Release No. 2052, 2002 WL 1997959, at *5 (Aug. 30, 2002), *aff'd*, 340 F.3d 501 (8th Cir. 2003).

[105] *Vernazza v. SEC*, 327 F.3d 851, 860 (9th Cir. 2003).

[106] *Dorozkho*, 574 F.3d at 49 (alteration and omission in original) (quoting *O'Hagan*, 521 U.S. at 653); *see also Finnerty*, 533 F.3d at 148 (holding that deception "irreducibly entails some act that gives the victim a false impression" such as "a false statement, breach of a duty to disclose, or deceptive communicative conduct"). *See generally Stoneridge*, 128 S. Ct. at 769 ("Conduct itself can be deceptive.").

[107] *See* Model Penal Code §223.3 (theft by deception) (stating that a "person deceives if he purposely: (1) creates or reinforces a false impression . . . or (3) fails to correct a false impression which the deceiver previously created or reinforced, or which the deceiver knows to be influencing another to whom he stands in a fiduciary or confidential relationship").

information, his failure to correct the misrepresentations operated as a "device" and "artifice" to defraud and an "act," "practice," and "course of business" that misled his clients.[108]

Malouf argues that in order to prove its claims under Exchange Act Section 10(b) and Rule 10b-5(a) and (c) (and Securities Act Section 17(a) and Advisers Act Section 206) "the Division was required to establish that [he] made a material misrepresentation or omission." As discussed above, we reject that view of primary liability under the antifraud provisions. Malouf's employment of a deceptive device and artifice to defraud and a deceptive act, practice, and course of business as part of the fraud suffices for liability so long as he acted with scienter.

b. Malouf acted with scienter.

We find that Malouf acted, at a minimum, with extreme recklessness in failing to promptly correct the material omissions in the Forms ADV and on the website. Malouf has acknowledged that he was familiar with the contents of UASNM's Forms ADV and website throughout the applicable period. Given this awareness and his admitted periodic reviews of the disclosures, we find that Malouf must have been aware that his conflict had not been disclosed to UASNM's clients.

Furthermore, the risk of misleading investors as to the true reason why their bond trades were directed to RJ was so obvious that Malouf must have been aware of it; indeed, the circumstances suggest that Malouf may have declined to correct the misleading disclosures precisely *because* he wanted to convey an incorrect impression about the reason he selected RJ for the trades. Malouf acknowledges that in June 2010 he disclosed to ACA his receipt of payments from Lamonde—at which point ACA immediately instructed UASNM to disclose this arrangement—but did not add corresponding disclosures to the Forms ADV and website until March 2011. Thus, while the evidence strongly suggests that Malouf was aware of the missing disclosures for many years, even the most favorable reading of Malouf's testimony makes clear that he was aware of the omissions for at least nine months before correcting them. Allowing such misleading communications to persist for such a long period of time demonstrates, at a minimum, a reckless disregard of the risk of misleading investors.

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[108] *See, e.g., SEC v. Shattuck Denn Mining Corp.* 297 F. Supp. 470, 476 (S.D.N.Y. 1968) (finding the "failure to correct the 'misleading impression left by statements already made,'" by one with a duty to do so, "constituted a fraud") (citing *Cochran v. Channing Corp.*, 211 F. Supp. 239, 243 (S.D.N.Y. 1962) (stating that the "fact that the defendants did not make any statements at all does not, in and of itself, deprive plaintiff of relief," that the "three subsections of Rule 10b-5 are in the disjunctive, and while subsection (2) seems to require a statement of some sort, subsections (1) and (3) do not," and that "[f]raud may be accomplished by false statements, a failure to correct a misleading impression left by statements already made or, as in the instant case, by not stating anything at all when there is a duty to come forward and speak"); *see also Bristol Myers Squibb Co. Secs. Litig.*, 586 F. Supp. 2d 148, 169-170 (S.D.N.Y. 2008) (finding defendant's "failure to correct [CEO's] and the Company's material misstatements despite his duties as a senior executive" deceptive even though he "made no public statements himself").

While clients believed that their trades were directed to RJ because it provided them with the best execution of their trades in the view of an impartial adviser, they very well may have reached a different conclusion had they known about the significant payments Malouf received from Lamonde.[109] Indeed, because the payments Malouf received were almost identical to the commissions RJ received on the trades Malouf directed to the RJ branch, and those trades were the source of the funds Malouf received from Lamonde as payment for Malouf's interest in the RJ branch, it would have been difficult *not* to conclude that Malouf's recommendations could be influenced by his personal financial interests.

Malouf claims that he did not act recklessly because he reasonably believed that Kopczynski, Hudson, and ACA were aware of his receipt of the payments from Lamonde and did not tell Malouf to disclose them. But both Kopczynski and Hudson testified that they were *not* aware of the arrangement, and the ALJ credited their testimony over Malouf's.[110] And it is undisputed that ACA was not aware of any payments until June 2010. Even had Kopczynski, Hudson, Ciambor, and ACA known about Malouf's arrangement with Lamonde, this would not defeat a finding of scienter. Malouf admitted that investment advisers have a duty to disclose a conflict of interest that might cause them to render self-interested investment advice. Thus, regardless of what others may have thought, Malouf, an experienced securities professional, had an independent obligation to disclose his conflict, understood that obligation, and must have known that clients would be misled by his failure to correct the representation that no conflict existed.[111]

Likewise, we do not find convincing Malouf's claims that his efforts as CCO to correct the misleading omissions in March 2011 demonstrate a lack of scienter. Malouf corrected the communications at issue only after they had existed in their misleading form for several years—

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[109] *See Curshen*, 372 F. App'x at 882 (finding scienter based on the "logical conclusion" that one who knew he was being compensated for promoting a stock also knew that the failure to disclose this compensation would mislead those reading his internet postings by making his opinions seem objective); *see also Gebben*, 225 F. Supp. 2d at 927 (internet poster who "knew that investors . . . would wrongly believe that his opinions represented independent research, rather than merely a recitation of what Issuers paid [his employing firm] to say" acted with scienter).

[110] We generally defer to an ALJ's demeanor-based credibility determinations, absent a showing that the substantial weight of the evidence warrants a different finding. *See Steven Altman*, Exchange Act Release No. 63306, 2010 WL 5092725, at *4 n.10 (Nov. 10, 2010) (citing *Anthony Tricarico*, Exchange Act Release No. 32356, 1993 WL 1836786, at *3 (May 24, 1993)), *petition denied*, 666 F.3d 1322 (D.C. Cir. 2011). The weight of the evidence does not warrant a different finding here.

[111] *See Orlando Joseph Jett*, Exchange Act Release No. 49366, 2004 WL 2809317, at *20 (Mar. 5, 2004) (rejecting applicant's claim that he lacked scienter because, among other reasons, even if applicant's "supervisors and co-workers knew about his fraud on the firm—indeed even if they ordered him to commit it—that would not relieve Jett of responsibility for what he knew or was reckless in not knowing and for what he did").

and only after ACA identified the critical omissions and warned that they would be cited in its annual compliance review.

Because we find that Malouf acted with scienter in employing a deceptive device and artifice to defraud and engaging in a deceptive act, practice, and course of business, we find that he violated Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c).

2. Malouf violated Securities Act Sections 17(a)(1) and 17(a)(3) by failing to correct the material misstatements on UASNM's Forms ADV and website.

Based on our analysis above, we also find that Malouf violated Sections 17(a)(1) and 17(a)(3) of the Securities Act.[112] Malouf's employment of a deceptive device and artifice to defraud with scienter establishes that he violated Section 17(a)(1). And Malouf admitted that he reviewed UASNM's disclosures on its Forms ADV and website periodically. That he repeatedly and continually failed to correct the disclosures that falsely stated UASNM had no conflicts of interest constituted a "practice" and "course of business" that operated as a fraud. Malouf's conduct was plainly unreasonable as it violated well-established professional and fiduciary standards. We therefore find that he also violated Section 17(a)(3).

3. Malouf violated Advisers Act Sections 206(1) and 206(2) by failing to correct the material misstatements on UASNM's Forms ADV and website and by failing to disclose his conflict of interest to his clients.

Malouf violated Section 206(1) and 206(2) by failing to correct the misstatements in UASNM's Form ADVs and on its website. "Facts showing a violation of Section 17(a) or 10(b) by an investment adviser will also support a showing of a Section 206 violation."[113] Therefore, given our determination that Malouf is liable under Section 10(b) and Section 17(a) for his conduct with respect to the misleading statements disseminated to his clients, we find that the same conduct renders him liable under Sections 206(1) and 206(2).[114]

We also find that Malouf violated Sections 206(1) and 206(2) by failing to disclose his conflict of interest with RJ to his clients. The Advisers Act "reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship,' as well as a congressional intent to eliminate, or at least expose, all conflicts of interest which might incline

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112 As discussed above, a violation of Section 17(a)(1) requires a showing of scienter, but negligence is sufficient for a violation of Section 17(a)(3). *See supra* note 73.

113 *E.g., SEC v. Haligiannis*, 470 F. Supp. 2d 373, 383 (S.D.N.Y. 2007).

114 *Cf. Montford and Co., Inc.*, Advisers Act Release No. 3829, 2014 WL 1744130 at *14, 16 (May 2, 2014) (finding registered investment adviser and its president and sole owner liable under Sections 206(1) and 206(2) for making material misrepresentations regarding registered investment adviser's independence on Forms ADV that president signed and on firm's website that were attributed to president), *aff'd*, 793 F.3d 76 (D.C. Cir. 2015).

an investment adviser . . . to render advice which was not disinterested."[115] The Act imposes this heightened standard of disclosure on investment advisers based on their "fiduciary status . . . in relation to their clients," as well as "Congress's general policy of promoting 'full disclosure' in the securities industry."[116] Accordingly, we have "long stated that advisers owe their clients 'a duty to render disinterested advice . . . and to disclose information that would expose any conflicts of interest,' including . . . even a potential conflict."[117] Malouf's extremely reckless failure to do so violates Section 206(1) of the Advisers Act, and his negligent failure to do so violates Section 206(2).[118]

As previously discussed, the information Malouf failed to disclose was material: Malouf's clients would have wanted to know about his arrangement with Lamonde before accepting his recommendation that RJ execute their transactions. His conduct was both reckless and negligent for all the reasons previously discussed. Accordingly, we find that by failing to disclose his conflict of interest, Malouf violated Sections 206(1) and 206(2).[119]

Finally, we note that we find Malouf primarily, rather than secondarily, liable under Sections 206(1) and 206(2) because, as UASNM's CEO and President, he received compensation in connection with giving investment advice and therefore falls under the broad definition of "investment adviser" in the Advisers Act.[120]

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115 *Capital Gains*, 375 U.S. at 191-92.

116 *Id.*

117 *Montford and Co.*, 2014 WL 1744130 at *13 (citing *Capital Gains*, 375 U.S. at 201).

118 *See id.* at *13-14, 16.

119 Although we find Malouf liable under the Advisers Act but not the Securities Act or the Exchange Act for his failure to disclose material information, that does not mean that liability under Rule 10b-5(a) and (c) (or Sections 17(a)(1) and (3)) may not arise solely from such nondisclosure. Indeed, the Supreme Court's statement in *Capital Gains*, 375 U.S. at 198-199, that a fiduciary's "nondisclosure" is "one variety of fraud or deceit" suggests that it could. Because in this case Malouf failed to disclose his conflict of interest but also failed to correct the misrepresentations that UASNM had no conflicts of interest, we need not determine in what circumstances a respondent may be held liable under Rule 10b-5(a) and (c) (or Sections 17(a)(1) and (3)) simply for failing to disclose material information despite a duty to do so.

120 *Koch*, 2014 WL 1998524, at *18 (citing 15 U.S.C. 80b-2(a)(11) and collecting cases).

4. Malouf violated Advisers Act Sections 206(1) and 206(2) by failing to seek best execution for his clients' bond trades.

An investment adviser's fiduciary duty "includes the obligation to seek 'best execution' of clients' transactions under the circumstances of the particular transaction."[121] The duty of best execution requires an investment adviser to "execute securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances."[122] Those circumstances include the "full range and quality of a broker's services in placing brokerage including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness to the money manager."[123] The "determinative factor is not the lowest possible commission cost but whether the transaction represents the best qualitative execution for the managed account."[124] Thus, although "the duty to obtain the best security price remains, in selecting a broker to secure such price an adviser is not required to seek the service which carries the lowest cost so long as the difference in cost is reasonably justified by the quality of the service offered."[125]

Nonetheless, we have long held that the "selection of a broker and the determination of the rate to be paid should . . . never be influenced by the adviser's self-interest in any manner."[126] Where "the adviser is affiliated with or has a relationship with the brokerage firm executing the transaction," the adviser "must make the good faith judgment that such broker is qualified to obtain the best price on the particular transaction and that the commission in respect of such transaction is at least as favorable to the company as that charged by other qualified brokers."[127] In essence, in "a case of self-dealing, the burden of justifying paying a commission rate in excess of the lowest rate available is particularly heavy."[128]

We have also explained that although an adviser "has no duty or obligation to seek competitive bidding for the most favorable negotiated commission rate applicable to such

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121 *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Exchange Act Release No. 54165, 2005 WL 4843294, at *2 & n.3 (July 18, 2006); *see also* Advisers Act Rule 206(3)-2(c), 17 C.F.R. § 206(3)-2(c) (acknowledging adviser's duty of best execution of client transactions); Amendments to Form ADV, Investment Advisers Act Release No. 3060, 2010 WL 2957506, at *16 (Aug. 12, 2010).

122 Exchange Act Release No. 23170, 1986 WL 630442, at *11 (Apr. 23, 1986).

123 *Id.*

124 *Id.*

125 *Applicability of Commission's Policy Statement on the Future Structure of Securities Markets to Selection of Brokers and Payment of Commissions by Institutional Managers*, Exchange Act Release No. 9598, 1972 WL 121270, at *2 (May 17, 1972).

126 *Id.* at *1.

127 *Id.* at *2.

128 *Id.*

transaction, it should consider such 'posted' commission rates, if any as may be applicable to the transaction, as well as any other information available at the time as to the level of commissions known to be charged on comparable transactions by other qualified brokerage firms. . . ."[129] Here, the Division's expert witness testified that because of their high liquidity and AAA rating, fulfilling the duty of best execution for transactions in the Treasury and agency bonds at issue was primarily a matter of finding the lowest available cost for the trade (*i.e.*, the commission paid), rather than any other factors related to trade execution, such as research. While acknowledging that it may be appropriate to execute a bond transaction without first seeking multiple bids in certain rare circumstances, the Division's expert opined that, because the commission cost is the driving factor in achieving best execution for these bonds, the best general practice was to seek multiple competing bids.

Malouf agreed that the best approach to an adviser's best execution responsibilities was to seek multiple competing bids for client transactions. He also acknowledged that Keller, on a few occasions during the applicable period, was able to convince the RJ branch to lower proposed commission amounts after he shopped his client bond trades to other brokers for competing bids. Nonetheless, Malouf conceded that he routinely failed to seek competing bids before directing bond trades to Lamonde's RJ branch.

The Division's expert also evaluated all of UASNM's client bond trades through the RJ branch during the applicable period and determined that dozens of such transactions involved commissions that were significantly higher than industry norms. He assumed that an appropriate commission level was 0.10-0.75 percent of the total dollar amount of the trade for highly-liquid, AAA-rated Treasury and agency bond transactions, a conclusion he reached from personal experience trading this type of security, as well as industry research and consultation with other experts.[130] Based on his analysis, he determined that UASNM's clients paid between $442,106 and $693,804 of commissions on 81 such bond trades in excess of what they would have paid if they had paid prevailing market commission rates.

Malouf effectively concedes that these commissions were excessive. He stipulated that there were approximately 81 bond trades exceeding $1 million executed by UASNM during the

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129 *Id.*

130 The expert, in his analysis, did not attribute any specific transaction to Malouf, but rather evaluated all of UASNM's bond trades through RJ during the period. The Division's expert also testified, and Malouf's expert agreed, that the best execution responsibilities of an adviser such as UASNM, which owes a fiduciary duty to its clients, are different from those of a broker-dealer, such as RJ, which does not. Therefore, as Malouf conceded, an adviser cannot rely on the broker-dealer to satisfy the adviser's own best execution responsibilities. Neither of the two expert witnesses who testified on behalf of Malouf offered a contrary estimate of the appropriate commissions to be charged on highly-liquid, AAA-rated Treasury and agency bond transactions. We, like the ALJ, rely on the testimony of the Division's expert witness in the absence of other evidence in the record, but our findings on the appropriate commissions to be charged on highly liquid agency bonds are limited to this matter. Determining the appropriate commission on a particular trade is a circumstance-specific inquiry. *See supra* notes 119-123 and accompanying text.

applicable period, that "for a $1 million Treasury bond an appropriate commission would be one percent, would drop to 0.5 percent above that then goes down from there," and that he and Lamonde had an oral agreement that RJ would not charge commissions exceeding one percent for such trades. Malouf does not dispute the expert witness's calculations with respect to UASNM's total bond trades used to calculate the excess commissions Malouf's clients paid.[131]

Malouf fails to meet his "heavy" burden of justifying paying a commission rate in excess of the lowest rate available. Even in cases where "there is no self-dealing," we have stated that "where commission rates reflect services furnished to the managed account in addition to the cost of execution, managers must stand ready to demonstrate that such expenditures were bona fide."[132] Malouf admitted that, when using BondDesk, he "would not know the precise commission that Lamonde was going to charge for the trade."[133] Malouf could not establish that the RJ branch actually provided lower costs for his clients than those of other brokers, and he fails to explain what services or efforts RJ provided that any other broker would not have for such routine, highly-liquid, AAA-rated Treasury and agency bond transactions.[134] Malouf's failure to justify the excess commissions his clients paid is especially problematic in light of his arrangement with Lamonde.

Malouf attempts to avoid liability by arguing that the Division has not introduced evidence connecting him to a specific bond transaction on which excessive commissions were charged and that therefore he cannot be held liable for excessive commissions, or related best execution violations, on any trades whatsoever. We reject Malouf's argument on several grounds. Testimony and documentary evidence shows that Malouf was responsible for UASNM's large-dollar-amount bond trades and that his clients were the parties to the bond transactions on which excessive commissions were paid. Malouf himself conceded that he executed anywhere from 60-70 percent of all of UASNM's bond trades. And as discussed above, 81 large-dollar-amount bond trades placed through the RJ branch, which the Division's expert witness reviewed, involved commissions exceeding the appropriate levels the expert set forth, and Malouf did not dispute the appropriate levels of commissions the Division's expert witness set forth.

Furthermore, using the highest rate that the expert witness testified might be acceptable (0.75 percent), the expert witness calculated that UASNM clients paid a total of $442,106 in

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131 Although Malouf claims that he made reasonable efforts to obtain best execution because he used RJ's BondDesk platform to research market prices, he offers no evidence showing how BondDesk's information regarding bid and ask spreads would inform Malouf as to the appropriate commission he should pay to a broker-dealer.

132 Exchange Act Release No. 9598, 1972 WL 121270, at *2.

133 Malouf also claims that he relied on his own experience trading bonds over many years to evaluate the fairness of a price, but he does not demonstrate how his years of experience could substitute for actual knowledge of commissions being charged in the market for particular trades.

134 *See Mark David Anderson*, Exchange Act Release No. 48352, 2003 WL 21953883, at *8 (Aug. 15, 2003) (finding that Treasury and agency bonds, such as those at issue here, are highly liquid and therefore a broker's efforts to execute trades in them are "in no way extraordinary").

excess commissions paid on all bond trades that were directed to the RJ branch during the period. Based on this calculation, the ALJ then used the lowest end of Malouf's own range of trades attributable to him (60 percent) to conclude that Malouf was personally responsible for at least $265,263.60 of those excessive commissions. We find that the ALJ's calculation was reasonable, and Malouf points to no evidence that would suggest using the assumptions for this calculation would be inappropriate. Given that several witnesses testified that the percentage of UASNM's bond trades that Malouf directed was likely much higher than 60 percent, and that Malouf was responsible for all large-dollar-amount UASNM client bond trades, the ALJ's calculations were a conservative estimate of the total excess commissions.

Malouf also argues that ACA bore some responsibility for monitoring UASNM's best execution compliance. Since, among other things, ACA did not identify a deficiency in those practices and ACA was aware that a significant percentage of UASNM's client bond trades were directed to the RJ branch, Malouf contends that he "conclude[d], reasonably, that [UASNM] met its best execution guidelines." Ciambor, however, testified that Malouf and others at UASNM told him that UASNM always followed a multiple bid process when executing client trades. Malouf also acknowledges that ACA did not review full trade blotters reflecting all UASNM client trades during this period, instead reviewing only a sample. Malouf admits that ACA was not aware until June 2010 of the payments Malouf received from Lamonde and that this was crucial information for ACA's evaluation of UASNM's best execution practices because Lamonde's ongoing payments provided Malouf with an incentive to allow his clients to pay RJ's higher commissions. Finally, Malouf stipulated that "ACA does not assume any of the fiduciary duties its clients are subject to as supervised persons under the Investment Advisers Act" and that "ACA does not undertake a duty to root out fraud on behalf of its clients." For these reasons, Malouf's claim that he understood that ACA had approved UASNM's best execution practices is unpersuasive.

We find that Malouf violated his duty to seek best execution for his clients. The result of Malouf's conduct was that his clients paid at least $265,263.60 in excess commissions to Lamonde's RJ branch. Lamonde paid Malouf an amount almost equal to the amount of the commissions Lamonde received on Malouf's clients' trades. Malouf admitted that he directed trades to the RJ branch because "then I got paid." Malouf benefitted at his clients' expense. He thus employed a device and artifice to defraud his clients and engaged in a practice and course of business that operated as a fraud or deceit upon his clients. And he did so with scienter. Malouf knew that he had an arrangement with Lamonde, that the best approach to UASNM's best execution responsibilities was to seek multiple competing bids, and that appropriate commissions on the trades of highly-liquid, AAA-rated Treasury and agency bond of over $1 million were not more than one percent. Malouf could have lowered his clients' costs if he had sought multiple competing bids from other brokers or insisted that the commissions on the trades stayed below one percent. His failure to do either, in light of his knowledge, evinces a reckless disregard for the risk that his clients would not receive best execution but would instead pay excess commissions to the RJ branch, which Lamonde would use to pay him. Accordingly, Malouf's failure to seek best execution for his clients violated Advisers Act Sections 206(1) and 206(2).[135]

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[135] *See Delaware Management Co.*, 43 S.E.C. 392, 1967 WL 88897, at *4 (July 19, 1967) (finding that an investment adviser's sale of stock through a broker at a lower price than that

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5. Malouf aided and abetted and caused UASNM's violations of Advisers Act Section 206(4) and Rule 206(4)-1 thereunder and Section 207.

To establish aiding and abetting liability, we must show: "(1) that a principal committed a primary violation; (2) that the aider and abettor provided substantial assistance to the primary violator; and (3) that the aider and abettor had the necessary scienter."[136] The level of scienter required for such a showing is "extreme recklessness."[137] An individual who aids and abets a violation of the Advisers Act is also a cause of that violation.[138]

Advisers Act Section 206(4) prohibits a registered investment adviser from engaging in "any act, practice, or course of business which is fraudulent, deceptive, or manipulative."[139] A primary violation of Section 206(4) requires neither a showing of scienter nor client harm.[140] Advisers Act Rule 206(4)-1(a)(5) prohibits a registered investment adviser from publishing, circulating, or distributing advertisements, including the contents of its website, containing untrue statements of material facts, or that otherwise are false or misleading.[141]

Based on our findings above, we find that UASNM violated these provisions by claiming on its website that its advice was impartial and conflict-free, while failing to disclose Malouf's receipt of $1,068,084 in payments from Lamonde, the owner of the RJ branch to which Malouf directed the overwhelming majority of UASNM's clients' bond trades. As we found above, Malouf recklessly failed to disclose this clear conflict of interest. Thus, he substantially assisted UASNM's violations. We therefore find that Malouf aided and abetted and caused UASNM's violations of Advisers Act Section 206(4) and Rule 206(4)-1(a)(5).

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offered by another broker in order to compensate the broker for research services performed for the adviser, where the adviser was contractually obligated to provide such services and received advisory fees for them, benefited the adviser at the expense of its client, was incompatible with the adviser's duty to obtain the best prices for its client, and constituted a fraud upon the client); *cf. Interpretations of Section 28(e) of the Securities Exchange Act of 1934; Use of Commission Payments by Fiduciaries*, Exchange Act Release No. 12251, 1976 WL 185942, at *1-2 (Mar. 24, 1976) (stating that investment advisers' practice of asking a broker, "retained to effect a transaction for the account of a beneficiary, to 'give up' part of the commission negotiated by the broker and the fiduciary to another broker designated by the fiduciary" may "constitute fraudulent acts and practices by fiduciaries" in violation of the antifraud provisions).

136 *Graham v. SEC*, 222 F.3d 994, 1000 (D.C. Cir. 2000).

137 *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004).

138 *Zion Capital Mgmt, LLC*, Advisers Act Release No. 2200, 2003 WL 22926822, at *7 & n. 36 (Dec. 11, 2003).

139 15 U.S.C. § 80b-6(4).

140 *SEC v. C.R. Richmond & Co.*, 565 F.2d 1101, 1105 (9th Cir. 1977) (citing *Capital Gains*, 375 U.S. at 195).

141 15 U.S.C. § 275.206(4)-1(a)(5).

Advisers Act Section 207 prohibits, among other things, the making of any omission of a material fact required to be stated in a report filed with the Commission, including Form ADV.[142] Advisers Act Section 207 does not require a showing of scienter.[143] Item 12.B of Form ADV Part II requires an investment adviser to describe all factors considered in selecting broker-dealers for execution of client trades and for determining the reasonableness of their commissions. UASNM's Forms ADV failed to disclose Malouf's receipt of $1,068,084 in payments from the owner of the broker-dealer to which Malouf directed the overwhelming majority of UASNM clients' bond trades as a factor it considered in selecting RJ as a broker-dealer for client trades. Thus, UASNM violated Advisers Act Rule 207 by failing to disclose this factor in its choice of broker-dealers. Malouf recklessly provided substantial assistance to UASNM's violation by failing to insist that the Forms ADV be changed to correct this omission, despite regularly reviewing the Forms ADV during the applicable period and recognizing the importance of disclosing this conflict. For these reasons, we find that Malouf aided and abetted and caused UASNM's violations of Advisers Act Section 207.

III. SANCTIONS

The ALJ barred Malouf from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for a period of seven-and-a-half years; prohibited Malouf from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter for a period of seven-and-a-half years; ordered Malouf to cease and desist from committing or causing violations, and any future violations, of Securities Act Sections 17(a)(1) and (a)(3), Exchange Act Section 10(b), Exchange Act Rules 10b-5(a) and (c), Advisers Act Sections 206(1), (2), and (4) and 207, and Advisers Act Rule 206(4)-1(a)(5); and imposed a third-tier civil penalty of $75,000. On appeal, the Division requests that we impose a permanent industry bar and order Malouf to pay disgorgement in the amount of $1,068,084; and Malouf requests that we vacate all sanctions ordered by the ALJ. Based on our consideration of the relevant factors, we impose a bar from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; impose a cease-and-desist order; prohibit Malouf from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; order Malouf to pay disgorgement of $562,001.26; and order Malouf to pay a single, third-tier civil penalty of $75,000.

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142 15 U.S.C. § 80b-7.

143 *Montford & Co.*, 2014 WL 1744130, at *16 & n.134.

A. Industry Bar

Advisers Act Section 203(f) authorizes us to bar any person who, at the time of the misconduct, was associated with an investment adviser, from "being associated with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization" if we find "on the record after notice and opportunity for a hearing" that the person willfully violated the securities laws and the sanction is in the public interest.[144]

The Division appealed the ALJ's imposition of a seven-and-a-half-year industry bar, contending that a permanent bar is a more appropriate sanction for Malouf's violations. Malouf appealed the imposition of any sanction and argued that no bar is warranted. As discussed below, we find that a bar without time limitation or a right to reapply is in the public interest.

1. Malouf's violations of the securities laws were willful.

Advisers Act Section 203(f) authorizes us to bar persons associated with investment advisers for willful violations of the securities laws. In this context, willfulness is shown where a person intends to commit the act that constitutes the violation; there is no requirement that the person also be aware that his actions violate any statutes or regulations.[145] Malouf does not dispute that he knew that he was committing the acts involved in directing the transactions to the RJ branch and then receiving funds back from Lamonde, who owned the RJ branch. Rather, he claims that he did not act "willfully" in failing to make the required disclosure because he relied on Kopczynski, Hudson, and others and, therefore, "reasonably believed that the disclosure had been made." Malouf's argument equates "willfulness" with scienter. But, to find willfulness, Malouf need only to have known he was directing clients' transactions to the RJ branch and receiving payments from Lamonde, and that he neither made the required disclosures nor required anyone else to make the required disclosures. In any event, as stated above, we find that Malouf acted with scienter in violating the antifraud provisions. Therefore, Malouf not only intended to commit the acts; he committed them with fraudulent intent.

2. Barring Malouf is in the public interest.

When determining what, if any, sanctions are in the public interest, we consider, among other things, (i) the egregiousness of the respondent's actions; (ii) the degree of scienter involved; (iii) the isolated or recurrent nature of the infraction; (iv) the respondent's recognition of the wrongful nature of his or her conduct; (v) the sincerity of any assurances against future violations; and (vi) the likelihood that the respondent's occupation will present opportunities for future violations.[146] We also consider whether the sanctions will have a deterrent effect.[147] Our inquiry is flexible, and no single factor is dispositive.[148]

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144 15 U.S.C. § 80b-3(f).

145 *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000).

146 *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

After considering these factors, we find that an industry bar is in the public interest. Malouf's betrayal of his clients' trust involved a core tenet of his responsibility as an investment adviser—his duty to disclose material facts, including his conflict of interest, to his clients. Malouf's failure to seek best execution also betrayed his clients' trust. Over a three-year period, Malouf directed hundreds of bond transactions to (and received payments from the owner of) the RJ branch, and had a secret arrangement under which he would receive for himself $1,068,084, an amount nearly equal to the commissions his clients were being charged by the RJ branch. For approximately 48-77 highly-liquid, AAA-rated Treasury and agency bond transactions, as a result of Malouf's directing the transactions to the RJ branch, his advisory clients paid more than $250,000 in excessive commissions. The violations and the deception were repeated and ongoing.[149]

Malouf shows virtually no recognition of the wrongfulness of his conduct. He argues that responsibility for the misleading statements and omissions in the Forms ADV and on UASNM's website rests with others, including Kopczynski, Hudson, and ACA. Likewise, Malouf claims that he did not act recklessly, but as explained above, we find that he acted with scienter.

We also find that there is a significant likelihood that Malouf will be presented with the opportunity to violate the securities laws in the future. Malouf continues to own and operate a state-registered investment adviser. His continued work as an investment adviser, combined with his apparent lack of understanding of the seriousness of his misconduct demonstrates that a bar is necessary to protect investors.

Given Malouf's egregious and repeated misconduct, and failure to acknowledge his wrongdoing or to understand the role he played in misleading his advisory clients, we believe that the ALJ erred in imposing a time-limited bar.[150] The ALJ cited Malouf's age (55) and

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147 *See Toby G. Scammell*, Investment Advisers Act Release No. 3961, 2014 WL 5493265, at *5 (Oct. 29, 2014) (citing additional authority).

148 *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at *15 (Dec. 21, 2007), *petition denied*, 334 F. App'x 334 (D.C. Cir. 2009) (per curiam).

149 Malouf objects to the fact that in his sanctions analysis, the ALJ cited hearing testimony of an expert witness who stated that in 44 years in the securities industry, he had "never seen a million dollars conflict of interest like this before." Malouf claims that this "was testimony presented in a separate state court proceeding between Mr. Malouf and Mr. Kopczynski." We have not relied on this testimony in determining that a bar is in the public interest.

150 The law judge barred Malouf "for a period of seven-and-one-half years." This departs from our usual practice in situations in which we find that a bar of limited duration may be appropriate. Typically, a so-called "time-limited" bar takes the form of a bar with a right to reapply after a certain period of time. *See, e.g., Eric J. Brown*, Exchange Act Release No. 66469, 2012 WL 625874, at *13 (Feb. 27, 2012) (barring respondent from associating with a broker, dealer, or investment adviser, with a right to reapply in non-supervisory capacity after

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assumed that, because Malouf would be over 62 by the time the bar expired, Malouf may not return to the securities industry, and if he did, he would retire soon after. In effect, the ALJ assumed that the seven-and-a-half year bar was enough to protect the public because, for all practical purposes, the bar was likely to extend until Malouf retired. We make no such assumptions. Instead of relying on Malouf's potential future retirement to protect the public interest, we impose a bar without time limitation.[151] Accordingly, Malouf is barred from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. Similarly, we prohibit, without time limitation, Malouf from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, pursuant to Section 9(b) of the Investment Company Act.[152]

B. Cease-and-Desist Order

Section 8A(a) of the Securities Act, Section 21C(a) of the Exchange Act, and Section 203(k) of the Advisers Act authorize us to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" those Acts or any rule promulgated thereunder.[153] In determining whether a cease-and-desist order is warranted, we consider not only the public interest factors discussed above, but also "'whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings.'"[154] We also consider whether there is a reasonable likelihood of future violations,

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two years), *petition denied sub nom.*, *Collins v. SEC*, 736 F.3d 521 (D.C. Cir. 2013); *Robert Rodano*, Advisers Act Release No. 2750, 2008 WL 2574440, at *8 (June 30, 2008) (barring respondent from associating with an investment adviser, but providing for a right to reapply after five years).

[151] Even under the bar that we impose, Malouf may seek consent from a relevant self-regulatory organization ("SRO") to associate with one of that SRO's member firms. Alternatively, Rule 193(a) of our Rules of Practice provides a process by which barred individuals can apply to the Commission for consent to become associated with an entity that is not a member of an SRO, *e.g.*, an investment adviser, an investment company, or a transfer agent. 17 C.F.R. § 201.193(a).

[152] The ALJ barred Malouf from these activities for 7.5 years. Unlike the Exchange Act, Securities Act, and Advisers Act provisions at issue in this proceeding, Section 9(b) provides for time-limited prohibitions. Although the Division did not appeal this aspect of the ALJ's decision, we have determined to review this aspect of the ALJ's decision on our own initiative. For the same reasons as discussed in our imposition of the other bars against Malouf, we find that a bar, without time limitation, pursuant to Section 9(b) is in the public interest.

[153] 15 U.S.C. §§ 77h-1(a), 78u-3(a), 80b-3(k).

[154] *Koch*, 2014 WL 1998524, at *21 (citing *KPMG Peat Marwick, LLP*, Exchange Act Release No. 43862, 2001 WL 47245, at *24-26 (Jan. 19, 2001)).

although the required showing of a risk of future violations in the context of a cease-and-desist order is significantly less than that required for an injunction, and "in the ordinary case, a finding of a past violation is sufficient to demonstrate a risk of future ones."[155] Our inquiry is flexible, and no single factor is dispositive.[156]

The discussion of the public interest factors in connection with the bar militates in favor of a cease-and-desist order. The additional factors relevant to cease-and-desist orders further support imposition of such an order here. Malouf's violations are relatively recent. Malouf's conduct was harmful to investors. Malouf argues that "there is no customer harm" because he paid UASNM's customers $506,083.74 as part of the settlement of the State Court Litigation. When determining whether a cease-and-desist order is appropriate, we consider whether the violation *caused* harm to investors, not whether investors were later made whole. For all of the above reasons, we impose a cease-and-desist order in the public interest.

C. Disgorgement

In a cease-and-desist proceeding we "may enter an order requiring accounting and disgorgement, including reasonable interest."[157] Disgorgement is an equitable remedy that requires the violator to give up wrongfully obtained profits causally related to the wrongdoing at issue.[158] Because disgorgement is designed to return the violator to where he or she would have been absent the violative conduct,[159] disgorgement should include all of the gains that flow from the illegal activity.[160] The Division, in seeking disgorgement, must present a reasonable approximation of profits causally connected to the violation.[161] Once the Division has presented such a reasonable approximation, any risk of uncertainty in calculating the disgorgement amount then falls on the wrongdoer, whose misconduct created the need for disgorgement.[162]

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155 *KPMG Peat Marwick, LLP*, 2001 WL 47245, at *26.

156 *Id*.

157 15 U.S.C. §§ 77h-1(e), 78u-3(e).

158 *SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1230 (2d Cir. 1989) (citing additional authority). Ordering disgorgement may also deter others from violating the law. *Id*.

159 *Zacharias v. SEC*, 569 F.3d at 471 ("[D]isgorgement restores the *status quo ante* by depriving violators of ill-gotten profits.").

160 *Koch*, 2014 WL 1998524, at *22 (citing *SEC v. JT Wallenbrock & Assocs*., 440 F.3d 1109, 1113-14 (9th Cir. 2006)).

161 *Id.* (citing *Laurie Jones Canady*, Exchange Act Release No. 41250, 1999 WL 183600, at *10 n.35 (Apr. 5, 1999), *petition denied*, 230 F.3d 362 (D.C. Cir. 2000)).

162 *See First City*, 890 F.2d at 1232 (finding that, once Commission has shown that its disgorgement figure "reasonably approximates the amount of unjust enrichment," the burden then shifts to respondents "to demonstrate that the disgorgement figure was not a reasonable approximation"); *Koch*, 2014 WL 1998524, at *22 & n.234.

In the proceeding below, the Division sought an order of disgorgement in the amount of $1,068,084, the amount of money Malouf received from Lamonde in undisclosed payments for the sale of the RJ branch. The ALJ found that this money constituted "legal profits" to Malouf for the sale of the RJ branch and was therefore not subject to disgorgement. The ALJ found that only the amount of excessive commissions that UASNM clients paid on their bond transactions (which the ALJ calculated to be $265,263.60) was subject to a disgorgement order, but declined to order Malouf to disgorge the excessive commissions in light of payments made by Malouf to clients in connection with the State Court Litigation.

We disagree with the law judge's disgorgement analysis. The $1,068,084 was not received through an untainted transaction immune from disgorgement. It was in no sense "legal profits." Malouf only received payment by sending UASNM clients' bond transactions to RJ so that Lamonde would be able to pay Malouf the amounts due under the sales contract. Once UASNM's client investments were directed to RJ, Lamonde paid back to Malouf the commissions RJ earned, nearly dollar for dollar. Malouf admitted the bond transactions were sent to the RJ branch "because then he got paid."[163] Yet he did not disclose this conflict of interest to his clients. Absent this fraudulent channeling of transactions, he would not have received the $1,068,084.[164] For these reasons, the full $1,068,084 paid by Lamonde to Malouf is causally connected to his violations and a reasonable approximation of Malouf's ill-gotten gains.

Malouf bears the burden of presenting evidence that the Division's approximation of his ill-gotten gains, with which we concur, is not reasonable. Malouf offers no alternative method of calculating the proper disgorgement amount, and the record is devoid of evidence of possible alternative measures of Malouf's ill-gotten gains. Malouf relies solely on the ALJ's finding that Lamonde's payments to Malouf were not "transaction-based" commissions, a finding the ALJ made in the context of determining that Malouf had not acted as an unregistered broker.[165] But

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[163] Even with the commissions RJ received from Malouf-directed trades, Lamonde was able to meet his other expenses only by taking on significant debt, providing further support for the conclusion that Malouf's directing trades to RJ was essential to the payments Lamonde made to Malouf.

[164] *See Montford*, 2014 WL 1744130, at *22 & n.194 (finding that investment adviser must disgorge full amount of payments received from an investment manager because respondent advisers "fraudulently misled clients to believe they were independent and did not take any money from investment managers at the same time they were arranging for and receiving substantial payments from such an investment manager" and citing investor testimony that they would not have paid respondents the moneys at issue because they would not have retained them as their advisers and would not have made the investments in question); *see also Edgar R. Page and PageOne Financial Inc.*, Exchange Act Release No. 32131, 2016 WL 3030845, at *13 & n.75 (May 27, 2016) (finding that, where respondent's clients would not have invested in certain funds if respondent had disclosed his conflict of interest to them—and "therefore could not have received the . . . payments [at issue]"—those payments were causally connected to his violations and thus subject to disgorgement).

[165] *See supra* note 2.

the ALJ's finding regarding whether Malouf received "transaction-based compensation" is a separate question from the issue of whether the monies Malouf received were ill-gotten gains causally related to his fraudulent conduct.

We order that Malouf disgorge the full $1,068,084 he received from Lamonde, minus $506,083.74 that he has already paid to UASNM clients in the State Court Litigation, resulting in a disgorgement order of $562,001.26, plus prejudgment interest.

D. Civil Money Penalty

Section 8A of the Securities Act, Section 21B of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act (the "Acts") authorize the Commission to impose penalties for violations of the Acts if it is in the public interest to do so. In considering whether a penalty is in the public interest, the Commission may consider:[166] (A) "whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement"; (B) "the harm to other persons resulting either directly or indirectly from such act or omission"; (C) "the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior"; (D) specified prior findings of misconduct; and (E) "the need to deter such person and other persons from committing such acts or omissions."[167] Congress also specified that we may consider "such other matters as justice may require."[168]

The Acts specify that penalties can be imposed "for each act or omission" in violation of the federal securities laws. For each such "act or omission," the Commission may impose a penalty under one of three tiers, depending on the nature of the violation: first-tier penalties for violations of the securities laws; second-tier penalties for violations of the securities laws that "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;" or third-tier penalties for violations that satisfy the requirement for a second-tier penalty and "resulted in substantial losses or created significant risk of substantial losses to other persons or resulted in substantial pecuniary gain." For violations occurring between February 15, 2005 and March 3, 2009, the maximum penalty per act or omission for a natural person is $130,000 for a third-tier penalty; for violations occurring between March 4, 2009 and March 5, 2013, the maximum penalty per act or omission for such a violation is $150,000.[169]

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166 15 U.S.C. § 78u-2(3); 15 U.S.C. § 80b-3(i)(3); 15 U.S.C. § 80a-9(d)(3); *see also Collins v. SEC*, 736 F.3d 521, 524-25 (D.C. Cir. 2013) (recognizing that "Congress guides the Commission's discretion by pointing to . . . factors" in penalty statute).

167 *Id*.

168 *Id*.

169 *See* 17 C.F.R. §§ 201.1003, Table III (setting forth penalties for conduct occurring after February 14, 2005); 201.1004, Table IV (setting forth penalties for conduct occurring after March 3, 2009); 201.1005, Table V (setting forth penalties for conduct occurring after March 5, 2013).

The Division requests that, like the ALJ, we impose a single $75,000 third-tier penalty on Malouf for his misconduct.[170] Third-tier penalties are appropriate because Malouf engaged in fraud, which resulted in substantial losses of $265,263.60 to his advisory clients and a substantial pecuniary gain to himself of $1,068,084. The factors we discussed in support of our decision to impose a bar on Malouf also weigh heavily in favor of a penalty in the public interest. Although Malouf has no disciplinary history, his misconduct was serious and grossly breached his fiduciary duty to his advisory clients by failing to disclose an obvious conflict of interest that influenced his investment advice.

We also find that there is a need for a civil penalty to deter Malouf and others from similar failures to disclose significant conflicts of interest to advisory clients. Congress recognized that penalties are especially warranted "if the violation is of a type that is difficult to detect."[171] Malouf's advisory clients had no reason to expect that he was receiving over $1 million from the owner of the branch office of a broker-dealer to which he directed their trades, making his fraud difficult to detect.[172] A civil penalty is important to deter Malouf (notwithstanding the bar) and others from engaging in such conduct in the future.

Neither party attempts to calculate a precise number of violative acts or omissions committed by Malouf, but UASNM filed with the Commission eight Forms ADV during the applicable period, none of which disclosed Malouf's conflict of interest, and the firm's website consistently and incorrectly claimed, over three years, that UASNM representatives received no compensation from any broker to whom they directed clients' trades and stated that UASNM's advice was conflict-free. Although a higher penalty could be calculated on the basis of several discrete violations, the Division seeks a single, third-tier penalty, and although the violations were serious, the Division seeks a penalty lower than the maximum amount available.

Malouf argues that no civil penalty is warranted because he claims that he committed no violations. As discussed above, we reject that claim. Malouf does not specifically challenge the ALJ's method of calculating the penalty amount except regarding his claimed inability to pay. Malouf claims that his liabilities exceed his assets by approximately $634,000. Malouf argues that, in assessing Malouf's ability to pay, the ALJ "arbitrarily" assigned a value of $300,000 to

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170 The ALJ based his penalty amount only on Malouf's failure to disclose to his clients Lamonde's payments and not based on Malouf's best execution violations, treating the repeated failure over three years as a single course of misconduct. The Division did not appeal this aspect of the ALJ's decision.

171 H.R. Rep. No. 101-616, at 21; *see also* S. Rep. No. 101-337, at 15 ("The Committee believes it is appropriate to enable the SEC to impose a higher penalty if the violation is of a type that is difficult to detect.").

172 Although Malouf is barred from association with a Commission-registered investment adviser, he continues to be associated with a state-registered adviser, as discussed above, and many of the applicable statutory provisions apply to all types of advisers. *See* Advisers Act Section 206, 15 U.S.C. § 80b-6 (making it "unlawful for any investment adviser" to engage in specified acts).

Malouf's current state-registered investment advisory business, as opposed to Malouf's proposed $100,000 valuation. He asserts that, if he is barred from the securities industry, the value of the business would be limited to approximately $7,500 (the value of its tangible assets), since the business would then be foreclosed from earning any revenues. Malouf also claims that the assets he possesses are illiquid, and that he has little income left after payment of monthly expenses. He further disputes the ALJ's finding that he is "an individual of aptitude and shrewdness who will undoubtedly find work in some other business profession," noting that the securities business is the only business in which he has ever worked. Malouf also claims that any civil penalty he is ordered to pay should be offset by his payment of $506,083.74 to UASNM clients and the $100,000 civil penalty that he paid on behalf of UASNM in a separate settled Commission administrative proceeding.[173]

The Division counters that Malouf repeatedly cited differing values for the state-registered investment advisory business, ranging from $0 to $100,000, and the Division argues, "Malouf's contradictory assertions of value should be given no weight." The Division argues that the ALJ adopted an acceptable method of valuing investment advisory businesses (at twice their annual trailing revenue) to come up with his valuation of $300,000. While Malouf himself would not be able to continue to earn revenues from the business if he is barred, the Division observes that "he could simply sell the business as has been done in the past, valued at twice its annual trailing revenue."

We note that we have the discretion to impose penalties notwithstanding a respondent's financial circumstances.[174] We also find the Division's arguments concerning the value of the state-registered investment advisory business to be more persuasive than Malouf's. While we believe the record supports some mitigation of the penalty based on ability to pay and (as the ALJ found) because of Malouf's payment of UASNM's $100,000 civil penalty and of $506,083.74 to UASNM clients in the State Court Litigation,[175] we do not believe that it would be appropriate to impose no penalty here. We find that, in light of Malouf's fraudulent

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173 *UASNM*, 2014 WL 2568398, at *8.

174 *See Gregory O. Trautman*, Exchange Act Release No. 61167A, 2009 WL 6761741, at *24 (Dec. 15, 2009) ("Even when a respondent demonstrates an inability to pay, we have discretion not to waive the penalty, . . . particularly when the misconduct is sufficiently egregious") (quoting *Philip A. Lehman*, Exchange Act Release No. 54660, 2006 WL 3054584, at *4 (Oct. 27, 2006) and declining to reduce penalty in light of egregiousness of respondent's actions).

175 *See supra* note 9. We note that we offset Malouf's disgorgement by the amount of his payment to UASNM clients as part of the State Court Litigation.

misconduct, which resulted in substantial losses to his advisory clients and pecuniary gain to him, a $75,000 civil penalty is warranted. In light of the higher number of violative acts and omissions established by the record, and the permissible penalty range of up to $150,000 per act or omission, a single third-tier penalty of $75,000 is conservative.[176]

An appropriate order will issue.[177]

By the Commission (Chair WHITE and Commissioner STEIN; Commissioner PIWOWAR, concurring separately).

Brent J. Fields
Secretary

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[176] The OIP in this proceeding was filed on June 9, 2014, and as discussed above, Malouf's fraudulent misconduct extended into March 2011. We considered only the conduct that fell within the five-year statute of limitations for the purposes of determining the civil penalty. *See* 28 U.S.C. § 2462 (setting five-year statute of limitations); *Gabelli v. SEC*, 133 S. Ct. 1216, 1220-24 (holding that statute of limitations under § 2462 begins to run when the violation occurs, not when it is discovered).

The Division requested oral argument; Malouf did not. In light of our determination of the case, we find that oral argument is unnecessary to aid our decisional process, and we hereby deny the Division's request for oral argument.

[177] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

Commissioner PIWOWAR, concurring:

Commissioner Piwowar concurs with the opinion, which concludes, among other things, that Dennis Malouf violated Sections 17(a)(1) and 17(a)(3) of the Securities Act and Section 10(b) of the Exchange Act and Exchange Act Rules 10b-5(a) and (c), based on failures to correct misstatements made to clients.

Several courts have found that misrepresentations and omissions alone are not sufficient to give rise to scheme liability.[1] In this case, however, there is no need to determine whether the holdings of those cases apply. Although not specifically described in the majority opinion as a basis for liability, Malouf engaged in activities beyond his failure to correct the misstatements. In particular, he admitted that he directed his clients' trades to the branch office he sold because then he got paid. In routing client transactions to the branch office he also failed to seek best execution, which resulted in clients' payment of excessive commissions. The excess commissions generated were then used to pay Malouf.

Because Malouf acted deceptively, employed deceptive devices and artifices to defraud, and engaged in deceptive acts, practices, and a course of business that operated as a fraud beyond his failure to correct misstatements, there is no need to address whether his failure to correct those misstatements alone is sufficient to find violations of Section 17(a)(1) and (a)(3) of the Securities Act and Section 10(b) of the Exchange Act and Exchange Act Rules 10b-5(a) and (c).

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[1] *See, e.g.*, *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057-58 (9th Cir. 2011) (collecting cases); *Public Pension Fund Grp. v. KV Pharm. Co.*, 679 F.3d 972, 987 (8th Cir. 2012) (following *WPP Luxembourg*); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177-78 (2d Cir. 2005) (applying similar rule).

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10115 / July 27, 2016

SECURITIES EXCHANGE ACT OF 1934
Release No. 78429 / July 27, 2016

INVESTMENT ADVISERS ACT OF 1940
Release No. 4463 / July 27, 2016

INVESTMENT COMPANY ACT OF 1940
Release No. 32194 / July 27, 2016

Admin. Proc. File No. 3-15918

In the Matter of

DENNIS J. MALOUF

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Dennis J. Malouf be barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, and it is further

ORDERED that Dennis J. Malouf be prohibited, permanently, from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, and it is further

ORDERED that Malouf cease and desist from committing or causing any violations or future violations of Sections 17(a)(1) and 17(a)(3) of the Securities Act of 1933, Sections 10(b) Securities Exchange Act of 1934 and Rules 10b-5(a) and (c) thereunder, and Sections 206(1), 206 (2), 206(4), and 207 of the Investment Advisers Act of 1940 and Rule 206(4)-1(a)(5) thereunder; and it is further

ORDERED that Malouf disgorge $562,001.26, plus prejudgment interest of $764,300.14, such prejudgment interest calculated beginning from January 1, 2008, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Malouf pay a civil money penalty of $75,000.

Payment of the amounts to be disgorged and the civil money penalties shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South MacArthur Blvd., Oklahoma City, OK 73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

By the Commission.

Brent J. Fields
Secretary