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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15255

In the Matter of

JOHN THOMAS CAPITAL MANAGEMENT GROUP, LLC, d/b/a PATRIOT28, LLC,

GEORGE R. JARKESY JR.,

JOHN THOMAS FINANCIAL, INC.,

ANASTASIOS "TOMMY' BELESIS,

Respondents.

THE DIVISION OF ENFORCEMENT'S OPPOSITION TO RESPONDENTS' JANUARY 5, 2018 SUBMISSION OPPOSING RATIFICATION

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The Division of Enforcement ("Division"), through its attorneys, submits the following Opposition to Respondents George R. Jarkesy, Jr. ("Jarkesy") and John Thomas Capital Management Group LLC, d/b/a Patriot28 LLC ("JTCM") (collectively, the "Respondents") Submission in Response to the Commission's November 30, 2017 Order Asserting Ratification of a Prior Appointment of Administrative Law Judges.

PRELIMINARY STATEMENT

This administrative proceeding involves misstatements and omissions of material fact by Respondents in the offer and sale of shares of two hedge funds (collectively, the "Funds"). Jarkesy was the manager of the Funds and JTCM was the Funds' adviser. After a multi-week hearing, Administrative Law Judge Carol Fox Foelak ("the ALJ") found that Respondents violated the antifraud provisions of the federal securities laws by making material misrepresentations and omissions concerning the Funds. In particular, the ALJ found that the Fund's private placement memorandum ("PPM") and marketing materials falsely represented that the Fund would not invest more than 5% of its capital in any one company and that the Funds would set aside sufficient cash to pay the premiums on certain life insurance policies that were part of the Fund's portfolio. *John Thomas Capital Management Group LLC d/b/a Patriot28LLC, George R. Jarkesy Jr. et al.*, Initial Decision Rel. No. 693 at 28, 2014 SEC LEXIS 4162 (Oct. 17, 2014) ("ID"). The ALJ also found that the Respondents made material misrepresentations and omissions concerning their relationship with John Thomas Financial, Inc. ("JTF"), the Funds' placement agent, and its president, Tommy Belesis, as well as material misrepresentations and omissions concerning the value of the Funds and the identity of the Funds' auditor. *Id.* at 29. Respondents were ordered to cease and desist from violations of the antifraud provisions, to disgorge, jointly and severally, ill-gotten gains of $1,278,597 plus prejudgment interest, and to pay a third-tier penalty of $450,000. In addition, Jarkesy was barred from the securities industry and from serving as an officer or director of a public or reporting company.

On December 19, 2017, the ALJ issued an order providing both the Division and the Respondents with an additional opportunity to submit any "new evidence" so that she could reconsider the record, including all substantive and procedural actions taken by her. The December 19, 2017 Order ("December 19 Order") followed an Order of the Commission dated November 30, 2017 ("November 30 Order") which had ratified the appointment of the ALJ and ordered the ALJ to undertake the reconsideration of the record described above.

In response to the December 19 Order, the Respondents submitted a 45-page brief introducing one new piece of evidence – the existence of a settlement in a civil action brought by one of the Funds' investors, pursuant to which Respondents paid approximately $500,000. The remainder of the brief was an attack on the legitimacy of the Commission's November 30 Order, an attack on the remedy of disgorgement, in general, and a rehash of many of the constitutional and procedural arguments that Respondents made in this action numerous times and which were repeatedly rejected by both the Commission and the ALJ. None of Respondents' arguments have merit and, in light of the lack of any meaningful new evidence, Respondents' have failed to provide any reason for the ALJ to modify her previous decisions.

ARGUMENT

I. THE COMMISSION'S RATIFICATION ORDER AND REMAND ORDER IS VALID AND HAS EFFECTIVELY REMEDIED RESPONDENTS' ALLEGED INJURY

A. None of Respondents' Challenges to the November 30 Order Have Merit

The primary argument in Respondents' submission is that the Commission's November 30 Order ratifying the agency's prior appointment of its Administrative Law Judges ("ALJs") and directing the ALJs to "[r]econsider the record, including all substantive and procedural actions taken by an administrative law judge" in proceedings is invalid. Respondents' Brief ("R. Br.") at 1-5. The Commission's November 30 Order itself forecloses Respondents' challenge to the Commission's ratification of the appointment of its ALJs. It is undisputed that the Commission, acting in its capacity as head of a department, has the constitutional authority both to appoint ALJs as inferior officers and to ratify any such appointments after the fact. *See* U.S. Const. Art. II, § 2, Cl. 2; 15 U.S.C. § 78d(b)(1); *Free Enterprise Fund v. PCAOB*, 561 U.S. 477, 512 (2010); *Wilkes-Barre Hospital Company, LLC v. National Labor Relations Board*, 857 F.3d 364, 370-71 (D.C. Cir. 2017). The Commission's order exercising that authority and ratifying the appointment of its ALJs is, moreover, binding on those ALJs. The scope of the inquiry before *this* ALJ is therefore limited to whether—having had her appointment ratified by the Commission—the ALJ should affirm or revise in any respect her prior actions in this proceeding.

Even if this ALJ could consider the validity of the Commission's ratification of its ALJs' appointments, however, Respondents err in their contention that the ratification was invalid. Respondents' argument appears premised on the false assumption that the act being ratified is the Commission's *delegation* of hiring authority. *See* R. Br. at 3. Thus, they insist, any ratification is "a nullity," since the Commission lacks the authority to assign this hiring power to others. *Id.*

But the Commission's order does not purport to ratify a prior *delegation*; rather, it ratifies the original decision to *appoint* the ALJs in the first instance. Whether the Commission may delegate certain hiring decisions is therefore beside the point—the only relevant question is whether the Commission is constitutionally authorized to appoint its ALJs. And, on that question, as noted above, there is no dispute.

Respondents' argument also appears to misunderstand the nature of ratification itself. Their suggestion that the Commission cannot ratify prior appointments made by its agents (*see* R. Br. at 3) runs counter to the doctrine's very purpose: to allow a principal to subsequently authorize the actions taken by an agent acting outside the scope of his or her authority. *Restatement (Third) Of Agency*, ch. 4, intro. note (2006); *id.* § 4.01 cmt. b; *United States v. Heinszen & Co.*, 206 U.S. 370, 382 (U.S. 1907); 1 Floyd R. Mechem, *Treatise on the Law of Public Offices and Officers* § 536 (1890). This ratification "operates upon the act ratified in the same manner as though the authority of the agent to do the act existed originally." *Marsh v. Fulton County*, 77 U.S. (10 Wall.) 676, 684 (1871).

Here, agency staff approved the initial hiring of the Commission's ALJs. Even assuming that this action exceeded the scope of the hiring officials' authority, that defect was subsequently remedied by the Commission's November 30 Order. 1 *Mechem* § 533 (ratification of an act "render[s] it good from the beginning and the same as though he had originally authorized or made it"); *accord, Heinszen & Co.*, 206 U.S. at 382 (ratification "retroactively give[s]" an agent's acts "validity"). Such defect has therefore been cured, so any Appointments Clause challenge necessarily fails.

B. The Reconsideration Procedures Provide a Remedy For all Alleged Harm

Respondents also err in attacking the procedures set forth in the Commission's November 30 Order as inadequate to remedy their alleged harm. In particular, Respondents complain that the time allotted for the ALJ's reconsideration of the record is insufficient and thus amounts to little more than a "rubber stamp" of the ALJ's prior decisions. R. Br. at 5-6. That is flatly incorrect. The Commission remanded this proceeding to this ALJ with instructions to reconsider the entire existing record and also has accorded Respondents the opportunity to introduce new evidence and submit new briefing. Respondents have availed themselves of this opportunity, submitting a 45-page brief that contains both new evidence and new legal arguments. And ALJs also were given the flexibility to adjust any deadline as appropriate.

Those procedures are more than sufficient to allow for a valid ratification decision. Indeed, courts have routinely upheld ratification decisions made after far less rigorous procedures. *See CFPB v. Gordon*, 819 F.3d 1179, 1186, 1192 (9th Cir. 2016) (upholding ratification after CFPB Director issued a "Notice of Ratification" stating: "I believe that the actions I took during the period I was serving as a recess appointee were legally authorized and entirely proper. To avoid any possible uncertainty, however, I hereby affirm and ratify any and all actions I took during that period."), *cert. denied*, 137 S. Ct. 2291 (2017); *FEC v. Legi-Tech*, 75 F.3d 704, 709 (D.C. Cir. 1996) (finding no basis to invalidate ratification despite noting that the respondent "may well be right in arguing that the Commission's 'review'" for purposes of ratification "was nothing more than a 'rubberstamp'"). Courts have thus not hesitated to uphold ratification decisions made after a de novo review of the existing administrative record. *See, e.g., Intercollegiate Broadcasting Sys., Inc. v. Copyright Royalty Bd.*, 796 F.3d 111, 118-19 (D.C. Cir. 2015) (De novo review of the record allows for a valid ratification decision, which does not require "a new hearing."); *Advanced Disposal Servs. E., Inc. v. NLRB*, 820 F.3d 592, 602-03 (3d Cir. 2016) (holding ratification valid where the ratifying authority acted with "full knowledge of the decision to be ratified" and made "a detached and considered affirmation of the earlier decision").

C. Respondents' Prematurity Argument is not Properly Directed to the ALJ

Respondents' complaint that the Commission has not yet ruled on their motion to dismiss (R. Br. at 6) is misplaced and, in any event, is moot. An objection based on the *Commission's* decision-making process is not properly directed to the ALJ. And, for all of the reasons noted above, the ground on which Respondents urge dismissal—the alleged Appointments Clause violation—has been cured by the Commission's Order, and Respondents' claim of ongoing injury is meritless. Respondents' challenge is therefore moot.

II. RESPONDENTS' CHALLENGES TO THE DISGORGMENT ORDER ARE WITHOUT MERIT

A. There Is No Monetary Limit on Disgorgement

Respondents attack this ALJ's disgorgement determination in the Initial Decision, but again their arguments miss the mark. To start, they are wrong in asserting that, after *Kokesh v. SEC*, 137 S.Ct. 1635 (2017), disgorgement cannot exceed the statutory limits on civil penalties. R. Br. at 11-12. The Commission unquestionably has authority to order disgorgement *in addition to* civil penalties in administrative proceedings—regardless of whether disgorgement is a penalty or an equitable remedy—under Exchange Act Section 21B(e). 15 U.S.C. § 78u-2(e) ("In any proceeding in which the Commission or the appropriate regulatory agency may impose a penalty under this section, the Commission or the appropriate regulatory agency may enter an order requiring accounting and disgorgement."). Civil penalties in administrative proceedings are separately authorized by Section 21B(a); the statute explicitly limits only those penalties, not disgorgement. 15 U.S.C. §§ 78u-2(a), 78u-2(b) (setting limits for penalties described in subsection (a)).

B. The Potential Statutory Penalty Amount Is Sufficient to Encompass both the Disgorgement and Penalty Amount in the Initial Decision

Even assuming that a disgorgement award is limited by the statutory penalty amount (which the Division denies), the potential penalty amount in this proceeding far exceeds the disgorgement and penalty actually awarded by the ALJ in the Initial Decision.

The ALJ set the penalty amount in this case by multiplying the statutory penalty ($150,000) by three, stating that the events at issue would be "considered as three courses of action – the violations arising from the material misrepresentations and omissions relating to (1) the life settlement component of the Funds' investments; (2) the corporate investment component of the Funds' investments; and (3) Respondents' relationship with JTF/Belesis – resulting in three units of violation." ID at 33. This, however, was not the only option available to the ALJ to determine the amount of the penalty. The ALJ could have set the penalty by multiplying the statutory amount by the number of harmed investors. *See Gerasimowicz*, Initial Decision Rel. No. 496, 2013 SEC LEXIS 2019 *18 (July 12, 2013) (Foelak, ALJ) (penalties determined by multiplying the statutory third-tier penalty by the number of fund investors harmed by the conduct) (*citing Steven E. Muth*, 58 S.E.C. 770, 813 (2005) ("we believe that a civil money penalty based on the number of customers that [the respondent] defrauded . . . is appropriate."); *SEC v. Glantz*, 94 Civ. 5737, 2009 U.S. Dist. LEXIS 95350 *17 (S.D.N.Y. Oct. 13, 2009) (multiplying the penalty by the number of victims); *SEC v. Milan Capital Group, Inc.*, 00 Civ. 0108, 2001 U.S. Dist. LEXIS 11804 (S.D.N.Y. August 14, 2001) (multiplying the penalty by each of the 200 defrauded investors, resulting in a $10 million penalty); *SEC v. Kenton Capital Ltd.*, 69 F. Supp.2d 1, 17 & n.15 (D.D.C. 1998) (assessing a $1.2 million penalty calculated by "multiplying the maximum third tier penalty for natural persons ($100,000) by the number of investors who actually sent money to [defendant] (12)"). Jarkesy testified that there were more than ninety investors in one of the funds and a document produced by Respondents and offered into evidence by the Division (but not admitted) shows that there were at least 103 investors harmed by the conduct. Thus, it would have been appropriate for the ALJ to issue a penalty equaling ninety times the statutory amount and up to 103 times the statutory amount.

Alternatively, the ALJ might have calculated the penalty by multiplying the statutory amount by the number of false statements. Because each monthly account statement starting in March 2009 was fraudulently inflated, it would have been appropriate to multiply the statutory penalty by the number of false account statements as well as the additional false and misleading marketing materials and periodic investor communications. *SEC v. Pentagon Capital Mgmt., PLC*, 725 F.3d 279, 288 n.7 (2d Cir. 2013) ("although we vacate the civil penalty award, we find no error in the district court's methodology for calculating the maximum penalty be counting each trade as a separate violation"); *SEC v. Coates*, 137 F. Supp.2d 413, 430 (S.D.N.Y. 2001) (multiplying the penalty amount by the number of violations); *Gualario & Co.*, LLC, Initial Decision Rel. No. 453, 2012 SEC LEXIS 497, *55-56 (Feb. 14, 2012) (multiplying the statutory penalty by three (representing the operation of the fund, and the sale of two notes). Consequently, the potential penalty that the ALJ could have ordered far exceeded the disgorgement and penalty amount she actually ordered. As such, even if Respondents' argument that disgorgement is limited by the statutory penalty amount, the disgorgement ordered in this case does not exceed that amount.

C. Respondents Have Not Met Their Burden to Demonstrate Offset

As described in the Initial Decision, the disgorgement amount of $1,278,597 represented the management fees Respondents received from the Funds. ID at 32. As described by the ALJ, this amount represents the "wrongfully obtained profits causally related to the proven wrongdoing." *Id.* at 15, 31. This amount did not represent the losses suffered by the Funds' investors or any other damage to the Funds. As the ALJ found, approximately $24 million was invested in the Funds by investors *Id.* at 12-13. While the ALJ did not quantify the amount of investor losses, she stated that there were "millions of dollars of losses incurred by the Funds' investors . . . ." Id. at 32.[1]

Respondents now argue that even if the Commission finds that it has authority to order disgorgement in addition to a penalty, the disgorgement amount must be reduced by $2,050,000, the settlement amount paid in a related investor action. This argument should be rejected. First, Respondents paid only $500,000 to settle the investor action. The majority of the settlement amount was paid by the Funds' auditors. (*See* Respondents' Exs. 1-2). As such, even if an offset were appropriate, a maximum of $500,000 would be allowable as an offset – not $2,050,000. *See Annable Turner & Co., Inc.*, Initial Decision Rel. No. 216, 2002 SEC LEXIS 3611 (Sept. 30, 2002) ("amounts paid by third parties to victims do not offset the amount of

[1] As of the date of the hearing, it was impossible to ascertain the exact amount of investor losses as Jarkesy could not identify or value any asset held by the Funds, except for some shares of Radiant Oil, even though he claimed the Funds were still in existence. (Jarkesy, Tr. 1314:20-1315:4; 63:15-16). As described in the Division's Post-Hearing Reply Brief, "[t]he evidence is that the Funds' assets are negligible. Two companies that were once the Funds' largest holdings are worthless: Respondents wrote down the value of their holdings in Galaxy to zero in July 2011, and America West declared bankruptcy in February 2013. The Funds lack resources to pay auditors or insurance premiums – there have been no audited financial statements since 2010, and Respondents were forced to let the life settlement policies lapse because the Funds could not afford to pay the premiums. Except for some restricted shares of Radiant Oil (which Jarkesy refuses to sell in violation of the terms of the PPM and Limited Partnership Agreement), and a single insurance policy, the Funds have no marketable assets." Division's Post-Hearing Reply Br. at 34-35.

disgorgement"). Moreover, of the $500,000 that Respondents paid in the settlement, 25% of that amount went to the attorneys and not to injured investors. Div. Ex. A attached hereto.

Second, Respondents have not met their burden of demonstrating that an offset is warranted. *See Timbervest*, LLC, Advisers Act Rel. No. 4492, 2016 SEC LEXIS 3153 (Aug. 22, 2016). In particular, Respondents do not explain the basis for their $500,000 payment to the investors. If such payment was to reflect the fees paid to Respondents – the basis for the disgorgement award in the initial decision – an offset might be warranted in order to avoid double payment. However, if the payment was to reimburse the investors for their investment loss, no offset would be warranted as that was not the basis for the disgorgement award.

Directly on point is the Commission's decision in *Montford & Co., Inc.*, Advisers Act Rel. No. 3829, 2014 SEC LEXIS 1529 (May 2, 2014). In that case, the Commission held that the respondents could not offset money that they paid "in restitution" to settle a civil suit. In so holding, the Commission stated that "[t]he record contains no information about the basis for this suit or the settlement amount. As a result, we cannot determine the merits of Respondents' offset claim. For example, if the alleged settlement payment constitutes reimbursement of advisory fees the client paid to Respondents during the time it was misled, such amounts would not warrant an offset because the disgorgement ordered does not include any advisory fees paid." *See also Calabro*, Exchange Act Rel. No. 75076, 2015 SEC LEXIS 2175, *182 (May 29, 2015) ("Calabro also fails to establish that any particular component of the settlement payment (to two customers) is attributable to disgorgement of his ill-gotten gains with respect to Williams."); *SEC v. Solow*, 554 F. Supp.2d 1356, 1364 (S.D. Fla. 2008) (court declines to offset arbitration award against disgorgement where basis for arbitration award was not same basis as disgorgement calculation).

The settlement documents attached to Respondents' motion papers do not indicate how the $500,000 amount was calculated and Respondents do not provide any explanation. The fact that the settlement amount was significantly less than the management fees, however, demonstrates that the settlement amount was not based on the management fees. Notably, each of the counts against Respondents in the Second Amended Petition in the Investor Action makes clear that the investors were seeking damages from Respondents. *See, e.g.*, Div. Exhibit B, Second Amended Petition, attached hereto at ¶ 248 ("Due to the breaches of fiduciary duties by Defendants JTCM and Jarkesy, the Funds and their respective limited partners have been damaged. Plaintiff seeks all damages available under the law"). As such, it is reasonable to assume that the settlement amount was linked to the damage caused to the Funds. Disgorgement is not the same thing as damages. "Damages are '[m]oney claimed by, or ordered to be paid to, a person as compensation for loss or injury.'" *See, e.g.*, *Citadel Securities LLC*, Exchange Act Rel. No. 78340, 2016 SEC LEXIS 2464 (July 15, 2016). Disgorgement, as per the Supreme Court in *Kokesh*, is designed to deprive defendants of the profits from their securities laws violations and is not necessarily compensatory. 137 S.Ct. at 1640, 1644.

Because Respondents have not met their burden to demonstrate that an offset is warranted, the disgorgement order should be ratified. If the ALJ believes, however, that her disgorgement award needs to be modified to reflect the new evidence of the settlement in the Investor Action, the maximum offset amount to which Respondents might be entitled is $500,000 and not $2,050,050.

III. RESPONDENTS' PURPORTED "DEFECTS" IN THE PROCEEDING HAVE <u>ALREADY BEEN REJECTED</u>

Respondents' arguments relating to supposed defects in the proceeding have been repeatedly raised, repeatedly responded to by the Division, and repeatedly rejected by the

Commission and/or the ALJ. Respondents cite no new evidence to suggest that the Initial Decision was incorrectly decided. As such, none of these arguments provide any reason why the ALJ should modify her Initial Decision. Below is a summary of Respondents' arguments and the Division's responses, with references to orders and submissions already in the record.[2]

A. Respondents' Constitutional Rights Were Not Violated

1. <u>The Selection of the AP Forum Raised no Equal Protection Violation</u>

Respondents contend that the Division's selection of the AP forum, rather than federal court, "intentionally, arbitrarily and malevolently" stripped them of their rights to due process and equal protection, among other things. R. Br. at 16-17. Specifically, Respondents argue that similarly situated parties were allowed to defend themselves in federal court, while Respondents' labored in the administrative forum where the Division enjoys a higher rate of success. *Id.*

The choice of forum is part of the Commission's executive function. *See* Div.'s Opening Appeal Br. at 19. Choice of forum is part of the discretionary decision making authority the Commission has in carrying out its statutory mandate to execute the law. It is no different than the decision-making authority that the Commission exercises every time it decides whether or not to bring an enforcement action at all, regardless of the forum, or when it decides which of the many potential statutory violations it chooses to bring. *Id.*

In answering Respondents' earlier argument that they have been treated differently than similarly situated parties, the Division has pointed out that to sustain such a "class of one" equal protection claim, Respondents must show that they were intentionally treated differently and that

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[2] The relevant orders and submissions referenced herein are the Commission's Order Den. Pet. for Interlocutory Review (Jan. 28, 2014) ("Commission's Jan. 28, 2014 Order"); the Commission's Order Den. Pet. for Interlocutory Review (Dec. 6, 2013) ("Commission's Dec. 6, 2013 Order"); the Initial Decision; the Division's Proposed Findings of Fact and Conclusions of Law (Apr. 7, 2014) ("Div.'s Proposed FFCL"); the Division's Mem. of Law (Apr. 7, 2014) ("Div.'s Mem."); and the Division's Opening and Response Br. (Mar. 16, 2015) ("Div.'s Opening Appeal Br.") (attached hereto as Exhibit C).

there is no rational basis for their disparate treatment. *See* Div.'s Opening Appeal Br. at 25-27 (*citing, inter alia, Village of Willowbrook v. Olech*, 528 U.S. 562, 564 (2000)). *See also* ID at 6-7. Despite the overwhelming case law that Respondents must show both a high degree of similarity to purportedly similarly situated parties and intentionally disparate treatment, Respondents – now nearly five years after first raising the "class of one" argument – still cannot show how they are similar to parties who litigated in federal court or how the Division has intentionally wronged them by litigating in the administrative forum.

2. There No Right to a Jury in the AP Forum

Respondents argue that the selection of the AP forum denied them their Seventh Amendment right to a jury trial and therefore denied them equal protection under the law. R. Br. at 17-24. Respondents discuss at length the importance of the jury trial in American history, yet in all their verbiage, they fail to discuss the controlling Supreme Court precedent in *Atlas Roofing Co. v. Occupational Safety & Health Review Commission*, 430 U.S. 442 (1977), where the Court held that administrative proceedings that lack juries do not violate the Seventh Amendment. *See* Div.'s Opening Appeal Br. at 24-25; ID at 7. The Supreme Court held that the Seventh Amendment does not "prohibit Congress from assigning the fact finding function and initial adjudication to an administrative forum with which the jury would be incompatible." *Atlas Roofing*, 430 U.S. at 450.

3. Respondents Were Not Denied Due Process by the Discovery Provided

Respondents assert that their due process rights were buried in the Division's 700 GB electronic "document dump" that lacked an effective means of searching or otherwise identifying the contents prior to the hearing. R. Br. at 24-27. Contrary to Respondents' complaints, the Division exceeded the discovery obligations imposed by Rule 230 of the Commission's Rules of

Practice. Not only did the Division make the investigative file available to Respondents for inspection as required by the rule (except privileged material and work product), but it also provided Respondents a free copy of the investigative file on a searchable hard drive, a "hot documents" file that included investigative testimony and exhibits, a "withheld documents" list, and a declaration that summarized all potentially exculpatory material in witness interviews. All discovery was provided in the form maintained in the staff's investigative files. *See* Div.'s Opening Appeal Br. at 11-13.

Moreover, even as they complain about the volume of discovery, Respondents fail to acknowledge that much of the 700 GBs the Division produced were Respondents' own records, which they had produced to the Division during the investigation.

The Commission ruled that the Division need not specifically identify exculpatory evidence or provide a "roadmap" for those documents. Commission's Dec. 6, 2013 Order at 9-10. The "open file" production is consistent with Rule 230, the Commission ruled, and the Respondents "do not seriously contend otherwise." *Id.* at 9; *see also* ID at 5-6.

B. The Commission Did Not Prejudge the Matter by Accepting Other Settlements

Respondents contend that the Commission prejudged the case against them by issuing an order against two settling respondents on Dec. 5, 2013, in which it made findings against the settling parties. R. Br. at 27-33. Despite a footnote in the settlement order specifically stating that any findings "are not binding on any other person or entity in this proceeding," Respondents argue that the findings prejudge the matter against them. *Id.*

The Commission has found – and the Court of Appeals for the Second Circuit has upheld – that where the Commission bases its decision on the record before it, and not the findings in a settled action, there is no prejudice or violation of due process. *See* Commission's Jan. 28, 2014

Order at 4 (finding no prejudgment of a non-settling respondent's case where Commission decision is based on record before law judge and is not influenced by findings in a settlement). *See also Sinclair v. SEC*, 444 F.2d 399, 401-02 (2d Cir. 1971) (finding no merit in argument that matter was prejudged where Commission's decision was based on hearing record and not on findings of settled action); ID at 3-4. The Division's full response to Respondent's assertion of prejudgment previously was made when the appeal of the Initial Decision commenced. *See* Div.'s Opening Appeal Br. at 6-11 (*citing, inter alia,* Commission's Jan. 28, 2014 Order).

C. The Division Complied with the Rule Requiring Production of Exculpatory Material

Respondents argue that the Division deliberately concealed exculpatory material in witness notes and a 700 GB "document dump" in violation of Commission Rule of Practice 230(b)(2), which assures due process by mandating compliance with *Brady v. Maryland*, 373 U.S. 83, 87 (1963). R. Br. at 34-35.

As described above, the Division did not withhold any potentially exculpatory materials from Respondents. It produced its entire investigative file except for privileged material and work product, and even with respect to materials not produced due to privilege, it summarized all potentially exculpatory material. *See* Div.'s Opening Appeal Br. at 14-15. It has long been held that an "open file" policy satisfies the requirements of *Brady*, and that there is no obligation for the government to sift through a voluminous production to locate anything favorable to the defense. *See Strickler v. Greene*, 527 U.S. 263, 283 n.23 (1999); *United States v. Warshak*, 631 F.3d 266, 297 (6th Cir. 2010); *United States v. Ohle*, 2011 U.S. Dist. LEXIS 12581, *7-11 (S.D.N.Y. Feb. 7, 2011).

Consistent with the Division's insistence that it has produced all exculpatory material with the rest of its non-privileged investigative file, the Commission found the Division's production to be consistent with Rule 230(b)(2) and *Brady*. Commission's Dec. 6, 2013 Order at 9-11. As described by the Commission, "[n]either Rule 230(b)(2) nor *Brady* requires the Division to prepare respondents' case for them." *Id.* at 9. "On its face, documents that the Division has produced to respondents have not been 'kept' or 'withheld' from them ... The Division's 'open file' production of its investigative file is consistent with the text of Rule 230(b)(2)." *Id.* *See also* ID at 5-6.

D. There Were No Improper Ex Parte Communications

Respondents argue that the Commission violated a provision of the Order Instituting Proceedings ("OIP"), the Rules of Practice and the Administrative Procedures Act because staff attorneys who investigated and prosecuted the matter against Respondents also participated in settlements with other respondents. R. Br. at 35-37.

The Division has provided a sound legal basis why Respondents' arguments are meritless. *See* Div.'s Opening Appeal Br. at 8-9 (*citing, inter alia, Jean-Paul Bolduc*, Exchange Act Rel. No. 43884, 2001 SEC LEXIS 2765, *5 (Jan. 25, 2001); *C. James Padgett*, Exchange Act Rel. No. 38423, 1997 SEC LEXIS 634, *59 (Mar. 20, 1997); *Atlantic Equities Co.*, Exchange Act Rel. No. 8118, 1967 SEC LEXIS 531, *28-29 (July 11, 1967), *aff'd sub nom, Hansen v. SEC*, 396 F.2d 694 (D.C. Cir. 1968). The Commission already has determined that "there is no compelling reason the communications [between the Division and the Commission] as to a proposed settlement by one respondent in a multi-party proceeding may not take place ex parte." *Stuart-James*, Exchange Act Rel. 28810, 1991 SEC LEXIS 168, *20 (Jan. 23, 1991). Excluding the staff "from presenting relevant facts concerning a negotiated settlement would lead to wrong decisions about which settlement offers merited acceptance. Such a result is not in the public interest and it not required by statute or rules." *Id.* at 12. *See also* ID at 3-4.

E. The Division Proved Violations of the Antifraud Provisions

As recited in the Division's post-hearing filings, and largely embraced in the Initial Decision, the evidence demonstrated that Respondents violated the antifraud provisions of the Securities Act of 1933 ("Securities Act"), the Securities Exchange Act of 1934 ("Exchange Act"), and the Investment Advisers Act of 1940 ("Advisers Act"). ID at 28-29; Div.'s Proposed FFCL at 1-65; Div.'s Mem. at 5-24. Respondents' assertions that the Division has not presented sufficient evidence to prove the charges in the OIP flies in the face of a voluminous record to the contrary, and the painstaking details – each tied to evidence in the record – recited in 164 itemized paragraphs in the Division's proposed findings of fact and conclusion of law. Notably, Respondents have submitted no new or additional evidence to demonstrate that they did not commit fraud, notwithstanding the fact that they have had five years to unearth more evidence. Because the Respondents have provided no new basis for the ALJ to reconsider her previous rulings, there is no reason for the ALJ to reconsider or alter her prior decision.

1. <u>The Division Proved Violations of the Securities Act and Exchange Act</u>

Respondents assert that the Division failed to establish the elements of fraud because it failed to introduce evidence that the statements in the PPMs, Limited Partnership Agreements or marketing materials were false or misleading when issued, or that Respondents were responsible for any false statements made by others. R. Br. at 38-40.

Respondents' argument that the Division introduced no evidence of fraud ignores the 164 paragraphs in the Division's post-hearing proposed findings of facts that cite to the record – often multiple times in each paragraph – pointing to voluminous evidence of fraud. The record includes documents produced by the Respondents, their service providers and investors that tie numerous false and misleading statements directly to the Respondents. *See* Div.'s Proposed

FFCL at 1-65. The Division's accompanying post-hearing memorandum of law applies the jurisprudence surrounding Sections 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder to the overwhelming evidentiary record. *See* Div.'s Mem. at 5-22; ID at 8-24 (findings of fact), 28-29 (conclusions of law). In the face of this record, the Division's proof of fraud is conclusive.

2. The Division Proved Violations of the Advisers Act

Respondents argue that the Division's main allegation concerning violations of the Advisers Act is the fraudulently inflated values of the Funds the Respondents managed. R. Br. at 41-42. However, Respondents argue, "[t]here is not one shred of evidence to prove that these valuations were objectively unreasonable." *Id.* at 42. Thus, according to the Respondents' argument, the Division "resorts to its unsupported postulation" that favoring the placement agent violated the Advisers Act. *Id.* at 42-43.

The Division presented extensive evidence that the Respondents overvalued the Funds they managed in violation of the Advisers Act. *E.g.,* Div.'s Proposed FFCL at 29-53, 62-64. *See also* ID at 15, 18-20, 28-29 (discussing valuation). The Division also offered evidence of the Respondents' breaches of fiduciary duty to the Funds by favoring the placement agent to the detriment of the Funds they were entrusted to manage. *E.g.,* Div.'s Proposed FFCL at 53 n.29, 54-62. *See also* Initial Decision at 29 (discussing role of placement agent in controlling Funds and receiving fees). On the basis of this record, Respondents' violations of the Advisers Act are convincingly proven.

F. The Division Proved Respondents Aiding and Abetting Liability

Respondents assert that because the Division failed to prove the Funds' primary violations of the antifraud provisions, it also cannot prove the Respondents aided and abetted the Funds' violations, since an element of the proof is the Funds' primary violation. R. Br. at 44-45.

As discussed above (and in lengthy submissions and the Initial Decision), the Division proved the Respondents' willful violations of the antifraud provisions of the Securities Act, the Exchange Act and the Advisers Act. The Respondents are the controllers and alter egos of the Funds. The Funds, therefore, by the same misconduct, violated the antifraud provisions, and the Respondents aided and abetted the Funds' violations. *See* ID at 29.

CONCLUSION

For the reasons set forth herein, the Division respectfully requests that the ALJ deny all relief sought in Respondents' Submission in Response to the Commission's November 30, 2017 Order Asserting Ratification of a Prior Appointment of Administrative Law Judges.

Dated: January 19, 2018

Respectfully submitted,

/s/ Todd D. Brody

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CAUSE NO. 2013-54408

PAUL F. RODNEY, derivatively on behalf of PATRIOT BRIDGE AND OPPORTUNITY FUND LP I, and EDWIN DEBUS, derivatively on behalf of PATRIOT BRIDGE AND OPPORTUNITY FUND LP II, Plaintiffs, vs. JOHN THOMAS CAPITAL MANAGEMENT GROUP LLC, n/k/a PATRIOT28 LLC, GEORGE R. JARKESY JR., JOHN THOMAS FINANCIAL, INC., ANASTASIOS "TOMMY" BELESIS, ATB HOLDING LLC, MFR, P.C., also known as MFR GROUP, INC., DOEREN MAYHEW & CO., P.C., DOEREN MAYHEW TEXAS, PLLC, SOUTH PADRE VENTURES 2, LLC, successors to MFR, P.C., and JUAN PADILLA, Defendants, PATRIOT BRIDGE AND OPPORTUNITY FUND LP I, and PATRIOT BRIDGE AND OPPORTUNITY FUND LP II, as nominal Defendants.	IN THE DISTRICT COURT OF HARRIS COUNTY, TEXAS 189th JUDICIAL DISTRICT

ORDER GRANTING APPLICATION FOR AN AWARD OF ATTORNEYS' FEES AND REIMBURSEMENT OF EXPENSES

Upon Plaintiffs' Counsel's Request for an Award of Attorneys' Fees and Reimbursement of Expenses relating to the Settlement among Plaintiffs and Defendants George R. Jarkesy, Jr. ("Jarkesy") and John Thomas Capital Management LLC (a/k/a Patriot28 LLC) ("Defendants") dated July 20, 2015; upon consideration of all papers submitted thereon; notice of the request having been given to the limited partners of Patriot Bridge and Opportunity Fund LP and Patriot Bridge and Opportunity Fund LP II; the Court having held a hearing on February 3, 2017, at which all persons who received notice had the opportunity to present their views; and the Court being fully apprised of the relevant facts and circumstances; NOW THEREFORE,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED as follows:

1. The Court hereby grants an award of attorneys' fees to be paid from the Settlement Fund, equal to 25% of the $511,729.28 ("Settlement Fund") ($127,932.32). The Court finds such an award to be fair and reasonable under the circumstances of this case, in light of, among others, the following factors:

a. the magnitude and complexities of the litigation;

b. the risk of the litigation;

c. the quality of the representation; and

d. the amount of the requested fee in relation to the settlement.

2. The Court hereby grants Plaintiffs' Counsel's application for reimbursement of litigation expenses in the amount of $1,233.18 to be paid from the Settlement Fund. The Court finds that these expenses were reasonably incurred in the prosecution of this litigation.

IT IS SO ORDERED.

DATED: ______________________

Signed: 2/3/2017

____
THE HONORABLE WILLIAM BURKE

3/10/2015 5:44:58 PM
Chris Daniel - District Clerk Harris County
Envelope No. 4447650
By: Bonisha Evans
Filed: 3/10/2015 5:44:58 PM

CAUSE NO. 2013-54408

PAUL F. RODNEY, derivatively on behalf of PATRIOT BRIDGE AND OPPORTUNITY FUND LP I, and EDWIN DEBUS, derivatively on behalf of PATRIOT BRIDGE AND OPPORTUNITY FUND LP II, Plaintiffs, vs. JOHN THOMAS CAPITAL MANAGEMENT GROUP LLC, n/k/a PATRIOT28 LLC, GEORGE R. JARKESY JR., JOHN THOMAS FINANCIAL, INC., ANASTASIOS "TOMMY" BELESIS, ATB HOLDING LLC, MFR, P.C., also known as MFR GROUP, INC., DOEREN MAYHEW & CO., P.C., DOEREN MAYHEW TEXAS, PLLC, SOUTH PADRE VENTURES 2, LLC, successors to MFR, P.C., and JUAN PADILLIA, Defendants, PATRIOT BRIDGE AND OPPORTUNITY FUND LP I, and PATRIOT BRIDGE AND OPPORTUNITY FUND LP II, as nominal Defendants.	IN THE DISTRICT COURT OF HARRIS COUNTY, TEXAS 189th JUDICIAL DISTRICT

PLAINTIFFS' SECOND AMENDED PETITION

TO THE HONORABLE JUDGE OF SAID COURT:

COMES NOW PAUL F. RODNEY and EDWIN DEBUS ("Plaintiffs"), by their attorneys, on behalf of Patriot Bridge and Opportunity Fund LP I ("Fund I") and Patriot Bridge and Opportunity Fund LP II ("Fund II") (collectively, the "Funds"), who files this

Second Amended Petition against JOHN THOMAS CAPITAL MANAGEMENT GROUP LLC, n/k/a PATRIOT28 LLC ("JTCM"), GEORGE R. JARKESY JR. ("Jarkesy"), JOHN THOMAS FINANCIAL, INC. ("JTF"), ANASTASIOS "TOMMY" BELESIS ("Belesis"), ATB HOLDING LLC ("ATB Holding"), MFR, P.C. ("MFR"), also known as MFR Group, Inc., DOEREN MAYHEW & CO., P.C. ("Doeren Mayhew"), DOEREN MAYHEW TEXAS, PLLC("DM Texas"), SOUTH PADRE VENTURES 2, LLC ("South Padre"), and JUAN PADILLA ("Padilla") and in support would respectfully show the following:

I. DISCOVERY CONTROL PLAN

1. Plaintiffs intend to conduct discovery under Level 2 of Texas Rule of Civil Procedure 190.3.

II. PARTIES

2. Paul Rodney is an individual and resident of Harris County, Texas. Plaintiff Rodney alleges the following based upon the investigation of plaintiffs' counsel, except as to allegations specifically pertaining to Mr. Rodney, which are based on personal knowledge. Mr. Rodney has continuously been a limited partner of Fund I since July 28, 2007. Mr. Rodney only alleges claims in this action against Defendants JTCM, Jarkesy, MFR, Doeren Mayhew, DM Texas, South Padre, and Padilla.

3. Plaintiff Edwin Debus is an individual and resident of Suffolk County, New York. Mr. Debus alleges the following based upon the investigation of plaintiffs' counsel, except as to allegations specifically pertaining to Mr. Debus, which are based on personal knowledge. Mr. Debus has continuously been a limited partner of Fund II since January 26, 2010.

4. The investigation of Plaintiffs' counsel included, among other things, a review of the pleadings, testimony and documents from the U.S. Securities and Exchange Commission's ("SEC") Administrative Proceeding (File No. 3-15255) (the "SEC Action"); public documents in related matters involving certain defendants and other publicly available data and information, an inspection of the books and records of Fund I, and documents and deposition testimony in this action.

5. The Funds are Delaware limited partnerships and during the Relevant Period ("July 28, 2007 through the Present") they had offices at 3 Riverway, Suite 1800, Houston, Texas, as well as at 800 Town and Country, Suite 300, Houston, Texas 77056. The Funds are named as nominal defendants. Before September 2011, the Funds were named the John Thomas Bridge and Opportunity Fund LP, I, and the John Thomas Bridge and Opportunity Fund, LP II.

6. Defendant JTCM is an unregistered investment adviser that serves as the general partner of the Funds. It is based in Houston, Texas and during the Relevant Period had offices at 3 Riverway, Suite 1800, Houston, Texas, as well as at 800 Town and Country, Suite 300, Houston, Texas 77056. On December 1, 2011, JTCM changed its name to Patriot28. JTCM has appeared herein.

7. Defendant Jarkesy, resides at [redacted], Tomball, Texas, [redacted]. During the Relevant Period, Jarkesy was the manager of JTCM. In that capacity, Jarkesy purportedly controlled all operations and activities of JTCM and the Funds. Jarkesy has appeared herein.

8. Defendant Belesis, is a resident of New York, New York. Belesis is the founder and chief executive officer of JTF, which is based in New York. Until late 2011,

JTF was the primary placement agent for the Funds, and was one of several broker-dealers that executed equity trade orders for the Funds. Belesis resides at [redacted], New York, New York [redacted]. Belesis has appeared herein.

9. Defendant JTF is a broker-dealer registered with the SEC and a member of FINRA. According to FINRA, JTF is registered with the State of Texas. During the Relevant Period, approximately 125 registered representatives were associated with the JTF. JTF is wholly owned by Defendant ATB Holding LLC, which is controlled by Belesis. JTF purportedly offered brokerage and investment services, investment banking services and private wealth management. Defendant JTF has appeared herein.

10. Defendant ATB Holding is owned and controlled solely by Defendant Belesis and is the alter ego of Defendants JTF and Belesis.

11. During the Relevant Period, Belesis, JTF and ATB operated from the same offices located at 14 Wall Street, 23rd Floor, New York, New York 10005.

12. Defendant MFR purportedly provided accounting services to the Funds during the Relevant Period. MFR has offices at One Riverway, Suite 1900, Houston, Texas 77056. MFR audited Fund I's financial statements for the years ended December 31, 2008 through 2010, and prepared certain Fund I's tax returns to the Internal Revenue Service for 2007 through 2010, which included, among other things, analyses of partners' capital account and analyses of Fund I's investment gains and losses. MFR audited Fund II's financial statements for the year ended December 31, 2010. According to filings with the Office of Secretary of State of Texas, on November 20, 2012, MFR changed its name to MFR Group, Inc. MFR has appeared herein.

13. Doeren Mayhew & Co., P.C., is a Troy, Michigan-based certified public accounting and advisory firm with locations in Troy, Michigan and Houston, Texas. On December 3, 2012, Doeren Mayhew merged with MFR. The merged entity operates under the Doeren Mayhew name. According to a Doeren Mayhew press release, as a result of the merger, MFR's partners and associates will become Doeren Mayhew employees, while co-founders Roland Rodriguez and Gasper Mir will continue involvement as Doeren Mayhew advisory board members, providing strategic guidance. According to the press release, both Rodriguez and Mir will also continue to own and manage MFR, P.C.-affiliated entities MFR Solutions and MFR Healthcare Solutions.

14. Doeren Mayhew is named as successor in liability to MFR and has assumed liabilities for MFR's conduct alleged herein. Doeren Mayhew has appeared herein.

15. DM Texas is a Texas professional limited liability company. DM Texas engages in business in the State of Texas, and is a Defendant in this proceeding arising out of business done in the State of Texas. DM Texas may be served through its registered agent for the service of process, Timothy R. Moore, at One Riverway, Suite 1200, Houston, Texas 77056, or wherever he may be found.

16. DM Texas is named as successor in liability to MFR and has assumed liabilities for MFR's conduct alleged herein.

17. South Padre is a Texas limited liability company. South Padre engages in business in the State of Texas, and is a Defendant in this proceeding arising out of business done in the State of Texas. South Padre may be served through its registered agent for the service of process, Timothy R. Moore, at One Riverway, Suite 1200, Houston, Texas 77056, or wherever he may be found.

18. South Padre Mayhew is named as successor in liability to MFR and has assumed liabilities for MFR's conduct alleged herein.

19. Padilla is a resident of Texas. He was an employee of MFR and is currently an employee of Doeren Mayhew. Padilla has appeared herein.

III. VENUE AND JURISDICTION

20. Venue is proper in Harris County pursuant to Section 12.5 the Limited Partnership Agreement ("LPA") of Fund I.

21. Further, venue is proper under Texas Civil Practice and Remedies Code Section 15.002(a) because all or a substantial part of the events or omissions giving rise to the claims occurred or are occurring in Harris County, Texas.

22. This Court has personal jurisdiction over JTCM because it maintains its principal place of business in Texas, engages in systematic contacts with the State of Texas, and has purposefully availed itself of the privilege of conducting activities in Texas.

23. The Court has personal jurisdiction over Jarkesy because he is a Texas resident, engages in systematic contacts with the State of Texas, and has purposefully availed himself of the privilege of conducting activities in the State of Texas.

24. The court has personal jurisdiction over MFR and Doeren Mayhew, DM Texas, and South Padre because during the Relevant Period each maintained an office in Houston, Texas, engaged in systematic contacts with the State of Texas, and purposefully availed themselves of the privilege of conducting activities in the State of Texas.

25. Further, this Court has personal jurisdiction over Defendants Belesis, ATB and JTF pursuant to Tex. Civ. Prac. & Rem. Code Section 17.042 because they conducted business and committed tortious acts within the State of Texas as alleged herein, and also because each

engages in continuous and systematic contacts with the State of Texas, and has purposefully availed itself/himself of the privilege of conducting activities in Texas. Defendant ATB is the parent company of Defendant JTF and is Defendant Belesis's alter ego. In July 2007, Christos Kalatoudis, a New York-based JTF broker solicited Mr. Rodney in Texas to invest in Fund I using the means and instrumentalities of interstate commerce, including the telephone.

26. The Court has personal jurisdiction over Padilla because he is a Texas resident, engages in systematic contacts with the State of Texas, and has purposefully availed himself of the privilege of conducting activities in the State of Texas.

27. This Court has subject matter jurisdiction of this cause because the damages to the Funds exceed minimal jurisdictional limits of this Court.

IV. FACTS

28. This Action alleges breach of fiduciary duty and aiding and abetting breach of fiduciary duty, breach of contract, civil conspiracy, and professional negligence.

29. Jarkesy individually, as the managing member of the Funds' general partner JTCM, and JTCM, the general partner of the Funds, owed fiduciary duties to the limited partners of the Funds. Jarkesy and JTCM intentionally, willfully or with at least gross negligence, elevated the interests of JTF, Belesis and ATB Holding over those of the Funds by steering millions of dollars in bloated fees to the broker-dealer, violating their duty of loyalty owed to the Funds' limited partners. Defendants JTF, ATB Holding, Belesis, Padilla and MFR aided and abetted such breaches of fiduciary duty. Further, Jarkesy and JTCM breached their agreement with the limited partners by ignoring the investments guidelines that governed the Funds. Defendant MFR breached its agreements with the Funds, and

Defendants MFR and Padilla committed professional negligence in connection with their audits of certain of the Funds' financial statements.

30. As alleged in further detail below, Jarkesy and JTCM breach their fiduciary duties by: i) recording arbitrary valuations without any reasonable basis for certain of the Funds' largest holdings, thus causing the Funds' performance figures to materially overstated and materially false and misleading; ii) failing to disclosure to the Funds' limited partners JTCM's and Jarkesy's repeated favoring of the pecuniary interests of Belesis, ATB Holding and JTF; and iii) misrepresenting the value of the limited partners' respective capital accounts, and thereby artificially inflating JTCM's and Jarkesy's management fees and expenses.

31. While they shared the same brand name, JTCM (the adviser) purported to be wholly independent of JTF (the placement agent).

32. Notwithstanding representations that he was "responsible for all of the investment decisions" of the Funds, Jarkesy, in breach of his fiduciary duties, capitulated to Belesis' aggressive demands regarding certain investment decisions. JTCM's purported independence from JTF was a sham designed to enrich Belesis at the expense of the Funds, and to insulate him from future accusations of wrongdoing.

33. In addition to capitulating to Belesis' demands regarding certain of the Funds activities, Jarkesy and JTCM abandoned their fiduciary duty to the Funds by negotiating arrangements whereby borrowing companies would divert large fees to JTF and Belesis using proceeds received from the Funds. For example, in connection with certain bridge loans made by Fund I, Belesis (acting through JTF) received hundreds of thousands of dollars in "fees" for providing little or no services.

34. Jarkesy and JTCM placed the interests of Belesis and JTF above the interests of the Funds, thereby violating the fiduciary duty that they owed to the Funds. For example, after being berated by Belesis for not delivering enough fees, Jarkesy promised him in an email in late 2009, "*We will never retreat we will never surrender and we will always try to get you as much [fees] as possible, Everytime [sic] without exception!*"

35. In December 2013, Defendant Belesis settled claims alleged against him in the SEC Action and, among other things, Belesis agreed to be banned from the securities industry. *See John Thomas CEO Belesis Agrees to Ban in Deal with SEC*, BLOOMBERG NEWS, Dec. 6, 2013.

36. The Annual Financial Statements JTCM provided to investors, which included MFR's audit reports, stated that JTCM "records its investments at fair value" and had adopted Financial Accounting Standard 157 for purposes of valuation of the Funds' holdings, although JTCM has no records of its pricing analysis to support its valuation.

37. Jarkesy, as the manager of JTCM, was responsible for ensuring that the values assigned to the Funds' investments were consistent with representations in the LPAs.

38. JTF had several roles relating to the Funds, although JTF and JTCM purported to be wholly independent. JTF served as the primary placement agent for solicitation of investments in the Funds; it served as the investment bank for some of the companies that received bridge loans from the Funds; and it acted as the broker for many of the Funds' equity trades. To date, JTF has received millions of dollars in fees related to the Funds.

39. At the end of 2011, Jarkesy valued Fund I at approximately $18 million to $20 million and Fund II at approximately $10 million. For the year ended December 31,

2010, MFR reported Fund I's "total return since inception" was twenty-four percent. According to Jarkesy's testimony in the SEC Action, the Funds' limited partner interests today are almost worthless. (Jarkesy Tr. 63:15-16).[1]

40. Under the applicable LPAs, Jarkesy earns an incentive fee only after investors earn a nine percent return. After that, he earns a twenty percent incentive fee on any profits above the first nine percent. In addition, he earns a two percent management fee to cover operational costs of the Funds, including his own expenses, such as travel.

A. Background on the Funds

41. Jarkesy and JTCM launched Fund I in 2007 and Fund II in 2009. Since September 2011, the Funds have been known as Patriot Bridge and Opportunity Fund LP I and LP II and since December 2011, JTCM has been known as Patriot28 LLC.

42. Jarkesy created JTCM as an unregistered investment adviser in 2007 to serve as the adviser to Fund I.

43. In 2009, Jarkesy and JTCM formed a twin fund: Fund II. With the termination of Fund I scheduled for 2012, Fund II was formed in order to hold certain longer-term investments, including life settlement policies that had not matured. Initially, Fund II was structured to solicit foreign investors, but when none bought shares, JTCM opened Fund II to domestic investors.

44. The Funds purported to invest in three asset classes: bridge loans to start-up companies; equity investments, principally in microcap companies; and life settlement policies.

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[1] Citations to "Tr. __" refer to transcripts of testimony in the SEC Action.

45. The Funds' assets under management reportedly peaked at approximately $30 million at the end of 2011. However, as alleged below, Jarkesy and JTCM wrongfully inflated the value of the Funds' assets under management.

B. Jarkesy's Baseless Valuation of Fund Holdings

46. Limited partners in the Funds received monthly statements indicating the value of their shares and gains or losses compared with previous time periods. Investors' monthly statements did not identify the Funds' holdings or the values of each of the Funds' positions, however the value of each limited partners' account was derived from a portion of the Funds' overall values.

47. Jarkesy and JTCM misrepresented the value of limited partners' investments in the Funds, which were based on an arbitrary and *ad hoc* methodology that differed from disclosures in the LPAs. As alleged more fully herein, Jarkesy's and JTCM's misrepresentations included incorrect valuations of the Funds' equity positions in certain companies, incorrect valuations of the Funds' short-term notes provided to other companies, and overstating the value of at least two of the Funds' life settlement policies.

48. JTCM's internal monthly holdings reports identified the Funds' holdings and the values of each position. The holdings reports served as the basis for the limited partners' interests, which JTCM reported to the Funds' investors on monthly statements. In addition, JTCM used the internal holdings reports to establish the Funds' performance, which was shared with existing and prospective limited partners. Finally, the net asset values of the Funds were the basis for calculating Jarkesy's management and incentive fees, which were deducted from the Funds and reduced the value of the limited partners' accounts.

49. For certain of the Funds' holdings, Jarkesy arbitrarily inflated valuations, causing his management and incentive fees, and the valuation of investors' accounts, to be materially overstated.

C. **Galaxy Media**

50. Galaxy Media and Marketing Corp. ("Galaxy Media") was formed in April 2010 when Amber-Ready, Inc. ("Amber-Ready"), a company in which the Funds had invested, merged with CK 41 Direct Inc. (DX-314 at 5.)

51. JTF and Belesis had a long-standing relationship with Amber-Ready. JTF had raised substantial amounts of capital for Galaxy through numerous private placements.

52. Jarkesy and JTCM first invested the Funds in Amber-Ready in 2009, when Fund I extended a bridge loan to the company. That loan was repaid, and another one was made at the end of the year. From that point on, neither of the Funds' loans to Amber-Ready was repaid; instead, the Funds received allotments of penalty shares of Amber-Ready and then Galaxy Media after the merger.

53. Documents sent to Jarkesy and JTCM demonstrate that they were keenly aware of Galaxy's precarious financial situation, and had been since before the Galaxy was formed.

54. In March 2010, in connection with the combination of Amber Ready and CK-41 and the creation of Galaxy, Belesis told Jarkesy in an email that all money raised needed to go to Amber Ready or it would go out of business. (DX-514 at 1.) Belesis wrote, "Amber has no more money." (*Id.*)

55. In September 2010, Gary Savage ("Savage"), the chief executive officer of Galaxy, sent Jarkesy projections for Galaxy's revenue based upon sales of PurEffect, an acne

treatment and the company's only product. The cover email described $550,000 of urgently needed funds: the money needed to be wired into various accounts by September 30, 2010, Savage wrote, and "there is no going past these dates." (DX-652 at 1 (6:32pm email, pph 2).) Savage's projections noted that additional cash infusions totaling more than $1 million were required in October and November 2010, and that an additional $5 million was required in January 2011. (*Id.*) Thus, in order to realize the approximately $8.5 million in gross profits Savage projected for 2011, more than $6.5 million was required in the short term just to get the project off the ground. (*Id.*)

56. In October 2010, Savage again wrote to Jarkesy (and others) about Galaxy's poor financial situation, which included: Galaxy's eviction within the week by the Westchester Sherriff and Marshalls, due to non-payment of rent; cancellation of Galaxy's insurance for directors and officers due to non-payment of premiums; and an impaired launch of PurEffect due to non-payment of some of Galaxy's vendors. (DX-518A.)

57. In October 2010, Jarkesy received Galaxy's financial statements, which corroborated Savage's concerns. The financials showed that from mid-2005 through mid-2010, Amber Ready and CK-41 together had total revenues of $45,198 and net losses of more than $18 million. (DX-661 at 3.) Galaxy's financial statements described more than $36 million of liabilities with only approximately $5.6 million of assets. (*Id.* at 2.) The notes to Galaxy's financials provided that the statements had been prepared on a "going concern basis" and stated that "[t]he Company's continued existence is dependent upon its ability to resolve its liquidity problems, principally be (sic) obtaining equity and or debt financing. The Company's current operations are not an adequate source of cash to fund future operations. In

the event that it is unable to obtain debt or equity financing, it may have to cease or curtail operations." (DX-661 at 8, pphs 6-7.)

58. In November 2010, Savage wrote to Jarkesy (and others) stating that the company was "without any money to operate" and that the launch of PurEffect could not take place as planned. (DX-521 at 2, pph 3.) Savage also complained that Belesis had promised that Galaxy's law firm would be paid, knowing that Galaxy had no money to make such payments on its own. Savage concluded that "unless we receive funds shortly from some source I will have no course but to take action to protect myself, the board of directors, and the companies' employees." (*Id.*)

59. An amended Form S-1 Registration Statement for Galaxy, filed with the Commission on February 11, 2011, provided extensive detail about Galaxy's financial condition, stating:

> We have incurred losses since our inception. For the years ended December 31, 2009 and 2008 we generated revenues of $13,272 and $716, respectively, and -incurred net losses of $75,808,771 and $9,835,053, respectively. At December 31, 2009, we had a working capital deficit of $12,853,708 and an accumulated deficit of $88,664,410. These factors raise substantial doubt about our ability to continue as a going concern . . . . To continue our operations and fully carry out our business plans for the next 12 months, we need to raise additional capital (up to $8,000,000) for which we currently do not have any contracts or commitments for additional funding.

(DX-314 at 5, pph 5.)

60. The Form S-1 noted that the net tangible book value per share (which represented net tangible assets divided by shares outstanding) was negative $0.80. *(Id.* at 12.)

61. Savage testified at the hearing in the SEC Action about his discussions with Jarkesy concerning Galaxy's financial condition. They discussed Galaxy's lack of liquidity

both before and after the merger. (Savage Tr. at 1592:2-8.) Savage told Jarkesy "almost every day" that Galaxy could not do the test run for its product, PurEffect, because it did not have the money it needed. *(Id.* at 1594:25-1595:6.) At no point during Savage's tenure as chief executive officer did Galaxy have sufficient funds to pay its operating expenses. *(Id.* at 1600:2-6.) All along, Savage had conversations with Jarkesy concerning the value of Galaxy's shares, telling Jarkesy that the shares weren't worth anything because the company had no real assets and no funding. *(Id.* at 1649:8-21.)

62. Defendants Jarkesy and JTCM arbitrarily and inconsistently valued the shares without any reasonable basis. The following chart reflects how Defendants Jarkesy and JTCM valued the Amber/Galaxy stock on a month-by-month basis from December 2009 through February 2011, and shows the disconnect between Galaxy's share activity and Defendants Jarkesy and JTCM's valuation.

Month	**Amber/Galaxy Stock Activity**[2]	**Shares Owned Fund 1**	**Value**
12/2009		27,251,316[3]	$0.35
112010		27,251,316	$0.35
2/2010		35,247,249	$0.30
3/2010		28,096,386	$0.30
4/2010	1:12 reverse split	28,098,386	$0.30
5/2010		28,098,386	$0.30
6/2010		2,341,366	$0.30
7/2010		2,341,366	$3.30
8/2010		2,341,366	$3.30
9/2010		11,223,465	$1.00
10/2010	Issued 19,350,492 shares	11,223,465	$0.80
11/2010	Issued 5,475,000 shares	11,223,465	$0.80
12/2010		11,223,465	$0.10

[2] The information in this column comes from Galaxy's Amended Form S-1 Registration Statement dated February 11, 2011. (DX-314.)

[3] The number for December 2009 and January 2010 includes 3.2 million shares of Amber Alert Safety Centers stock and 24,051,316 shares of Amber Ready Inc. restricted stock. (DX-301.)

112011	Issued 15,197,871 shares	14,286,669	$0.10
2/2011		14,286,669	$0.10

63. Between April 2010 and January 2011, Defendants Jarkesy and JTCM improperly recorded valuations in the Funds' holdings of Galaxy. In April 2010, Galaxy effectuated and reported a 1:12 reverse stock split. (DX-314 at 4.) This stock split, however, was not reflected on Fund I's holding pages until June 2010, when Defendants Jarkesy and JTCM reduced the Fund's holdings from more than 28 million shares to approximately 2.3 million. (DX-301 at JTBOF 19148.) Moreover, Defendants Jarkesy and JTCM did not reflect the price change resulting from that anti-dilutive action on the holding pages until July 2010. *(Id.* at JTBOF 19145.)

64. In October 2010, Galaxy issued more than 19 million shares to certain note holders as a penalty for Galaxy's failure to complete its Form S-1 registration statement on a timely basis. (DX-314 at 155.) Defendants Jarkesy and JTCM reported this increase a month early and, without any reasonable basis, gave themselves the extra shares in September. (DX-301 at JTBOF 19139.)

65. In November 2010, Galaxy issued approximately 5.5 million shares to its chief executive officer and its board of directors. (DX-314 at 156.) This was a dilutive act that reduced the Funds' ownership of the company, but Defendants Jarkesy and JTCM did not correspondingly reduce the price of the shares in the Funds. (DX-301 at JTBOF 19133.)

66. Again, in January 2011, Galaxy issued more than 15 million shares to certain note holders as penalty shares for its failure to complete the Form S-1 registration

statement on a timely basis. (DX-314 at 156.) Yet again, Defendants Jarkesy and JTCM did not reduce the value of the Funds' position. (DX-301 at JTBOF 19127.)

67. Defendants Jarkesy and JTCM also loaned significant amounts of the Funds' money to Galaxy, which was memorialized in debentures and promissory notes. (DX-316 at 20-21.) None of the promissory notes issued after November 2010 was secured, violating Defendants Jarkesy and JTCM representations that the bridge loans would be "collateralized." (*See* DX-260; DX-248.) Moreover, Galaxy was in default on a number of other loans from the Funds. (DX-316 at 21.)

68. Notwithstanding the company's poor financial condition or the fact that notes were in default, Defendants Jarkesy and JTCM continued to value these loans at par until July 2011. (DX-301, *compare* JTOBF 19108 *with* JTBOF 19112.)

69. By July 2011, Jarkesy wrote off the Funds' investment in Galaxy Media.

70. Jarkesy's valuations of Galaxy Media shares were arbitrary and inconsistent with Jarkesy's obligation to use his discretion to make reasonable valuation determinations as disclosed in the LPAs, and resulted in the recording of unreasonable and unsupported valuations on JTCM's monthly holdings reports. The inflated valuations on the monthly holdings lists served as the basis for valuing shareholders' individual positions in the Funds, which were reported to them on monthly statements. Performance results for the Funds, and management and incentive fees for the adviser and manager, also were derived from the baseless and unreasonable values Jarkesy recorded on the monthly holdings lists.

D. Radiant Oil & Gas: Jarkesy Hired Promoters to Boost the Share Price

71. In 1996, Jarkesy personally invested in a publicly traded shell company ("G/O Business Solutions" or "GOBS")) that, after a later merger, would become Radiant Oil & Gas. Jarkesy was chairman of the board of directors of the shell; in 2007, when he formed JTCM and the Funds, he stepped down as chairman but remained a director.

72. Jarkesy and JTCM invested approximately $200,000 of the Funds' money in GOBS, and the Funds became the shell company's controlling shareholders. GOBS merged with a small, private oil and gas company in the summer of 2010 to form Radiant Oil & Gas, a microcap oil and gas exploration company. The Funds owned approximately twenty-five percent of Radiant Oil & Gas's unrestricted stock after the merger, which Jarkesy valued by reference to its publicly quoted share price. At the time, public trading of Radiant Oil & Gas's shares in the over the counter market had only recently commenced and was extremely thin.

73. Between November and December 2010, Radiant Oil & Gas's share price jumped from $1 to $4. Accordingly, Jarkesy revalued the position on JTCM's monthly holdings reports, causing a material improvement in the Funds' performance. The beneficial spike in Radiant Oil & Gas's stock price did not, however, correlate to any disclosed corporate event.

74. On December 17, 2010, for the first time in more than fifteen months, there was a public sale of the shares of Radiant. This transaction of a 250 shares brought the stock price up to $4.00 per share. (DX-111 at 4.) From December 17, 2010 until the end of 2010, the stock traded on four additional days with a total volume of 3,300 shares, ending the year at $4.00 per share. (*Id.*) Using that share price, Jarkesy and JTCM's valuation of Fund I's Radiant position reflected an unrealized gain at year-end of nearly $7 million, which

represented more than a $5 million gain from the previous month. (DX-301 at JTBOF 19130, 19133.) Fund I's financial statements for year-end 2010 claim that the "fair value" of the equity position in Radiant was $6,936,996. (DX-317 at schedule of investments.)

75. Likewise, Fund II's financial statements for year-end 2010 claim that the "fair value" of the equity position in Radiant was $1,746,320. (DX- 318 at schedule of investments.)

76. In fact, the dramatic increase in the price was the result of a promotional campaign Respondents financed from Fund II. In December 2010, Respondents used Fund II's money to hire MEC Promotions to run a promotional campaign for Radiant. (DX-306c at 2.)

77. Defendants Jarkesy and JTCM knew that the fair value of Radiant's stock was not $4.00. They knew that the reason why the stock price had increased so dramatically to $4.00 was the promotion run by MEC Promotions for which Fund II its investors had paid. (DX-306c.)

78. In addition to its position in Radiant common stock, Fund II also owned 125,000 warrants to purchase shares of Radiant. (*E.g.*, DX-303 at JTBOF 19288.) (Warrants resemble options but are issued by the issuer instead of being an instrument issued by a stock exchange or a market participant.)

79. In February 2011, in connection with the issuance of the monthly financial statements for January, the Funds' administrator requested information about the value of the warrants. (DX-333.) Jarkesy and JTCM informed the administrator that the value should be $6.92 per warrant. (*Id.*) When the administrator questioned this valuation, stating that the warrants had last been priced in August 2010 at $0.12, JTCM's controller responded:

"I know the stock price was crazy in Jan for ROGI [Radiant]. Checked with George [Jarkesy] and he said to run with it at $6.92." (*Id.*)

80. At January's end, however, the price of the stock had fallen to $2.25. (DX-111.) As such, there was no reasonable basis for the $6.92 warrant price. (*See id.*)

E. <u>America West Resources</u>

1. Jarkesy and JTCM failed to write down the value of notes in default

81. In December 2007 Jarkesy and JTCM purchased 16 million shares in Fund I of Reddi Brake Supply Corp. ("Reddi Brake"), a predecessor company to America West, for $400,000 (DX-627 at 1; DX-301 at 19258.) On that same date, Jarkesy purchased for his personal account 4 million shares of Reddi Brake for $100,000. (DX-627 at 1.) Shortly thereafter, Reddi Brake changed its name to America West. (DX-625 at 2.)

82. As Jarkesy described in an April 2008 newsletter to investors, Fund I owned approximately sixteen percent of America West. (DX-215 at 1.)

83. As part of the investments in December 2007, Jarkesy joined the board of directors and "became a very active member of management [of America West] from that point forward until his resignation." (DX-310 at 36; Walker Tr. at 626:9-14.) Also joining the board of directors with Jarkesy was Brian Rodriguez ("Rodriguez"), who became America West's chief financial officer. (DX-310 at 38.) Rodriguez and Jarkesy previously had worked together at an internally managed fund called SH Celera Capital Corp., where Jarkesy was the president and chief operating officer and Rodriguez was the chief financial officer. (DX-310 at 36-38.) Furthermore, Rodriguez was Jarkesy's partner in a company called Marathon Advisors LLC ("Marathon") (DX-625 at 11.)

84. In December 2007, at the same time Jarkesy and Rodriguez joined America West's board, America West hired Marathon and, in addition to paying Rodriguez's salary, issued 1.5 million shares to Marathon. (DX-627.) In addition to purchasing America West common stock, Jarkesy and JTCM loaned Fund I's money to America West. In March 2008 they loaned $50,000 and three months later, in June 2008, they loaned an additional $200,000 of Fund I's money. (DX-301 at JTBOF 19247, JTBOF 19235.)

85. By the end of 2008, Fund I had eight notes from America West totaling $925,000. (*Id.* at JTBOF 19211.) In connection with these loans, Fund I received additional shares of the company. America West paid off these loans in January 2009. (DX-203 at 13-14; DX-301 at JTBOF 19207.)

86. In 2009, Respondents loaned more money from Fund I to America West. In May 2009 they loaned $805,000 from the Fund (DX-311 at F-15), and in November 2009 they extended two more notes totaling $210,000 (DX-301 at JTBOF 19170). In December 2009, Respondents loaned additional money and America West's debt to Fund I was consolidated into a single note for $1,330,000. (*Id.* at JTBOF 19167.) By the close of 2009, all of these loans were in default. (DX-311 at F15-16.)

87. Notwithstanding the fact that America West had defaulted on more than a million dollars of loans in 2009, Jarkesy continued to lend Fund I's money to America West throughout 2010. As of year-end 2010, Fund I owned twelve America West notes totaling $1,725,500. (DX-301 at JTBOF 19131.) Many of these new notes were also in default; the notes had matured in October 2010 but had not been repaid as of December 2010. (*Id.*)

88. Additionally, and despite America West's growing debt to Fund I, Jarkesy loaned money from Fund II to America West. As of year-end 2010, Fund II owned seventeen notes totaling nearly $1.4 million. (DX-303 at JTBOF 19287.) Fourteen of these notes also were in default as the notes had matured between October and December 2010 and had not been repaid as of December 2010. (*Id.*)

89. As described in America West's Form 10-K filed with the Commission, "between February and December 2010, two entities [Funds I and II] controlled by a director of America West [Jarkesy] loaned the Company an aggregate of $1,567,885. The loans are **unsecured,** bear interest at 10% per annum and mature between March 15, 2010 and March 31, 2010." (DX-311 at F-16, emphasis added.) Jarkesy and JTCM's loans of Fund money to America West on an unsecured basis violated their assurances that bridge loans would be "collateralized." (*See* DX-260; DX-248.) The vast majority of these loans were not repaid. (Walker Tr. at 633:13-18.) Rather, in June 2011, much of the debt was converted into equity and America West issued nearly 13 million shares of common stock to the holders of the promissory notes. (DX-346 at 30, pph 13; Walker Tr. at 633:19-25.)

90. As a member of America West's board of directors and an active member of management, Jarkesy was well aware that Ameica West was in default on its loan obligations to the Funds. Indeed, he signed the Form 10-K that discussed the default. (DX-311 at 50.) Based on his active role in management, Jarkesy was on notice that America West could not repay these notes. (*See id.*) Even though America West was in default on virtually all of the loans as of December 21, 2010, including the unsecured loans, Respondents did not write down the value of any of the notes. (DX-301 at JTBOF 19131; DX-303 at JTBOF 19287.)

91. In auditing the Funds, MFR did not review the public filings of America West to determine whether America West was in default.

92. Instead, the auditors relied on Jarkesy to tell them if any of the notes were impaired. (Padilla Tr. at 1047:6-1048:8, 1159:6-10.)

2. Jarkesy and JTCM valued America West common stock based on inflated prices

93. On December 31, 2010, the stock price of America West closed at $1.95. (DX-110 at 1.) This represented a significant increase in America West's stock price from October 19, 2010, when the closing price was $0.96 per share. (*Id.* at 3.) Jarkesy should not have taken advantage of the higher price at the end of the year because he knew it to be a temporary boost that he orchestrated by loaning money from the Funds to America West to finance a stock promotion campaign.

94. In 2010, Jarkesy participated in a series of deceptive efforts to boost America West's share price. In July 2010, Jarkesy was interviewed by an individual named Mike Norman ("Norman") that was published on the hardassetsinvestor.com website in a two-part series. In the first part of the interview, Jarkesy, who was identified as a director of America West, stated, "the outlook for coal is very bullish," and investors would see coal prices "increasing substantially" over the next five to ten years. Norman enthusiastically repeated Jarkesy's statements. (*See* DX-251 at pphs 3-4.) In the second part of the interview, Jarkesy stated, "[i]n about two to three years you're going to see a drastic increase- triple, quadruple- in coal pricing." Norman again repeated Jarkesy's statements. (DX-252 at pph 4.) At no time in either part of the interview did Jarkesy disclose that he was the general partner of the Funds, America West's largest investor. And at no point during either part of the interview did Norman or Jarkesy disclose that Norman was not an independent voice

discussing the future of coal. *See* DX-251; DX-252.) Rather, Norman was the chief market economist for Defendant JTF --the investment banker for America West and the placement agent for the Funds. (DX-253.) Jarkesy knew that Norman worked for JTF. (DX-630.)

95. America West issued a press release about Jarkesy's interview with Norman. The press release and a link to the interview were sent immediately to investors of both Funds, as Jarkesy instructed. (DX-628 at AM_SEC00006786; DX-250.) Again, Jarkesy failed to disclose to investors that Norman was an employee of Defendant JTF and, therefore, not independent. (*See id.*) In September 2010, Jarkesy sent a link to the interviews to all of his Twitter followers. (DX-629.) Yet again, Jarkesy failed to disclose Norman's relationship to Defendant JTF or his lack of independence. *(See id.)*.

96. In addition to the Norman interviews, Jarkesy sought to boost America West's share price by using money from Fund II to finance purported news articles touting America West's business. (DX-309 at JTBOF 06837 (*e.g.*, payments to Ron Irwin and Venture. Research).) There is no evidence that Jarkesy disclosed to Fund II investors that he used their Fund's assets for promotional purposes.

97. Two promotional articles Fund II financed by loaning money to America West were by Ron Irwin, a journalist, whose reports about America West were published on the Examiner.com website in August and early September 2010. (DX-254; DX-255.) The September article described Jarkesy's interview with Norman and focused on Jarkesy's comments about how the price of coal would spike over the next several years. As Irwin wrote: "contemplate what can happen should you own a commodity source for a commodity whose global demand is growing at rate of three to four hundred percent. Take a wild guess on how that will impact the price." (DX-255 at 5, pph 1.)

98. Jarkesy also used money from Fund II in August 2009 to pay a consulting firm, Venture Research LLC ("Venture Research"), for a favorable report on America West. Not surprisingly, this paid consultant issued a report on September 13, 2010 with a "buy" recommendation. (*See* DX-239.) The report opined that America West was "grossly undervalued at current prices" and explained that in making its determination, an "important factor is the commitment of the lead investors to fund the Company through this transition stage and to realize their shared vision." (*Id.* at 20.) Venture Research described itself as "an independent research and consulting firm". (*Id.* at 25.) Neither the report nor Jarkesy disclosed that the Respondents already had paid $5,000 of Fund II's money to America West to pay Venture Research for the report. (*See* DX-309 at JTBOF 06837.)

99. Jarkesy caused Spectrum, the administrator for the Funds, to send the Venture Research report to the Funds' investors without disclosing to the administrator (or to the investors) that Fund II loaned the money to America West so the company could pay for the favorable report. The cover email attaching the report simply states "please see attached research report on America West Resources; one of our largest holding companies in the Fund." (DX-239.) Jarkesy also sent the report directly to JTF brokers for distribution to investors, again without disclosing the relationship among Venture Research, America West or Fund II. (DX-616.) Referring to America West by its ticker symbol, AWSR, Jarkesy wrote in his cover email, "I think this is a great report explaining the past and where AWSR is Sep 2010."

100. Coffey, the registered representative at JTF who testified at a hearing in the SEC Action, said that he had he known America West had paid for the report, he would have thrown it away immediately. (Coffey Tr. at 1859:7-16.)

101. Finally, Jarkesy introduced America West to three companies- MEC Promotions, Uptick Capital, and Park Avenue Consulting Group- in order to launch a stock promotion campaign. (Cowell Tr. at 885:10-15.) It was Jarkesy's idea to hire these public relations and promotional firms, and the America West "relied heavily on Jarkesy's experience in this area. He spearheaded our efforts in that regard." (Walker Tr. at 629:22-630:3.)

102. Defendants Jarkesy and JTCM used the Funds' money to pay for the America West promotion; Jarkesy transferred the money directly from the Fund I's bank account to the promoters. Jarkesy used Fund money to pay MEC Promotions $10,000 in October 2010 (DX-306 at 2), $50,000 in December 2010, (DX-308 at 2), and $15,000 in January 2011 (DX-306d at 1; DX-307A at 2). Jarkesy used Fund money to pay Uptick Capital $7,500 each in November and December 2010 (DX-307 at 2; DX-308 at 2) and $5,000 in January 2011 (DX-306D at 2.) Jarkesy used Fund money to pay Park Avenue $5,000 in September 2010 (DX-306B at 2) and another $5,000 in January 2011. (DX-306D at 2.)

103. In addition to the payments Jarkesy made from the Funds' bank accounts to the promotional firms, America West issued 25,000 shares to Park Avenue, 30,000 shares to Uptick, and 150,000 shares to MEC Promotions. (DX-311 at 30-31.)

104. Matthew Cowell ("Cowell"), a founder of MEC Promotions, testified in the SEC Action that during the time his firm was engaged by America West, it sent emails to its subscribers containing public information that it found about America West, and also posted that information on its website. (Cowell Tr. at 886:9-21.) In addition, to its own subscribers, MEC Promotions subcontracted work out to "a lot" of other promoters who would send the same information to their own subscribers, Cowell said. (*Id.* at 887:6-16.) MEC Promotions

also owned websites called "pennyprofilers.com," "Dancing with the Bulls," and "Kaboom Stocks" where it promoted small companies that paid for their information to be posted on the site. *(Id.* at 873:18-874:21). The fact that the largest payment to MEC Promotions relating to America West was in December 2010 indicated to Cowell it was then that most of the promotional activity occurred. *(Id.* at 890:17-23.)

105. America West's share price rose to $1.95 by the end of the 2010. (DX-110.) As the architect of America West's promotional campaign that started in the summer of 2010, Jarkesy was well-aware that the year-end stock price reflected the promotion efforts financed by Funds, including the email blasts that were sent by MEC Promotions and its subcontractors in December 2010. Despite knowing of the temporary and artificial spike in America West's share price, Jarkesy valued the shares on December 31, 2010 based on the inflated stock price. (DX-110; DX-301 at JTBOF 19130.)

F. Life Settlement Policies

106. Jarkesy and JTCM represented that 50% of limited partners' money would be invested in life insurance policies. (DX-206, at 30; DX-211, at 5; DX-214, at 2). Jarkesy and JTCM further represented that they would acquire life insurance policies with a fact value of 117% or more of the aggregate capital commitments. (DX-206, at 2; DX-261, at 1, 10; DX-215, at 2; DX-260, at 2; DX-217 at 1; DX-637, at 2; DX-221 ("For a return of capital, we segregate half of the Fund's investment in life settlement policies . . . .") (emphasis in original); DX-259 (same); DX-248 (same)). Arthur Coffey, an employee of Defendant JTF, testified at a hearing in the SEC Action that the insurance was viewed and spoken of as a hedge to be able to protect the principal:

Q. So the intention of the insurance was to protect the principal that people had invested?

A. It was viewed and spoken of as a hedge to be able to protect the principal.

Q. Okay. And this information of the 117 or 150 percent did that come from Mr. Jarkesy?

A. Yes.

(SEC Tr. at 1828:3-11).

107. Jarkesy repeatedly represented that that half of the money invested in the Fund would be invested in life settlement policies. In an email to the accountants who handled the Funds' taxes, Jarkesy wrote: "[y]ou are correct that half of the capital contributions are to purchase and service LSP [life settlement policies]." (DX-605 (email of Mar. 12, 2008 at I 2:35pm).) In a podcast interview following the issuance of the December 31, 2008 financial statements, Jarkesy was asked what the Fund would do if an investor contributed one dollar. Jarkesy responded that "50 percent of that goes into life settlements. Approximately 30 percent of the life settlement portfolio buys a dollar's worth at face, and 70 percent of the life settlement portion is set aside to pay premiums through the life expectancy." (DX-203 at 22:2-6, emphasis added.)

108. During a podcast, Jarkesy also stated that "our charter requires that we have 117% of the value of our investor cash in face value life settlement policies. We do this not to make money. We do it because at the end of the fund, we want our investors to have some assurance that they get their money back. And will like life settlements for doing this." (*Id.* at 3:2-7, emphasis added).Jarkesy and JTCM spent only $3,865,309 of Fund I's money on life settlement policies (including purchase price and premiums) through December 31, 2010. (DX-317 at Note 3 to the financial statements.)

109. Jarkesy and JTCM failed to comply with the requirements set forth in Paragraphs 100-102.

110. The Funds raised more than $24 million in aggregate capital contributions, and thus would have been required to commit $12 million toward life settlement policies had they abided by Jarkesy's representations and statements in marketing materials he drafted. (DX-317 at Note 9; DX-318 at JTBOF 06311). Had Jarkesy set aside the approximately $8.135 million that they represented they would, there would have been sufficient funds to pay the premiums for all of the policies purchased. Jarkesy could not answer what happened to this money. (Jarkesy Tr. at 2617:17-2618:2.) The money was not set aside to pay premiums, as the majority of the policies lapsed for nonpayment of premiums. (*See e.g.* DX-418; DX-404.) Jarkesy testified that two of the insureds died and that the Fund still owns one of the policies. (Jarkesy Tr. at 250:21-252:4). The remaining 10 policies lapsed. (*See e.g.* DX-418; DX-404.)

111. In addition, there were long periods of time in 2008 when Jarkesy and JTCM failed to acquire and maintain policies with a total face value of 117% of the investors' capital contributions in the Funds. As of December 31, 2008, Fund I had approximately $16.62 million of investor capital (DX-315 at Note 7.) Therefore as of that date, Jarkesy and JTCM were required by their charter and their own representations to have purchased policies with face value of approximately $19.4 million. Yet Fund I had purchased policies with face value of only $13 million, more than $6 million shy of the promised amount. (DX-405.)

112. Similarly, in 2009, Jarkesy and JTCM fell short of the insurance coverage they promised investors. As of December 31, 2009, Fund I had received capital commitments amounting to $18,358,002. (DX-316 at Note 10.) And as of that same date, Fund II had received capital commitments of more than $800,000. (DX-249.) With total investor capital of

approximately $19.158 million by year-end 2009, Jarkesy and JTCM were required to purchase insurance policies for the Funds with face value of more than $22.4 million. However, the Funds owned policies with face value of only $21.5 million. (DX-405.)

113. Because Jarkesy and JTCM did not purchase any additional policies after May 2009 but continued to raise capital through at least 2010, the Funds were not in compliance with the 117% requirement at any time from December 31, 2009 forward. By December 31, 2010, Fund I had capital commitments of $20,112,852 (DX-317 at Note 9), and Fund II had capital commitments of $4,083,209 (DX-318 at JTBOF 0631 1).

114. With combined capital commitments of $24,196,061, Respondents were required by their own representations of 117% coverage to purchase insurance policies for the Funds with face value of $28,309,391. However, the Funds had policies with face values amounting only to $21.5 million. (DX-405.) During this time, Respondents continued to falsely represent that they had 117% face value. (DX-221; DX-248.)

115. Jarkesy and JTCM, with the knowing participation of MFR, overstated the value of Fund I's insurance policies.

116. For Fund I's 2010 audit, an issue arose concerning the valuations for several of Fund I's insurance policies when one of the insurance carriers sued to have the policies voided.

117. On April 16, 2010, Ohio National Life Assurance Corp. ("Ohio National") filed suit in the United States District Court for the Northern District of Illinois (10cv2386) seeking a declaration that the Shirlee Davis policy was void. (DX-337.)

118. The lawsuit alleged that the defendants-Paul Morady, Movash Morady, an independent insurance broker with American Pacific General Agency Inc. and APG Insurance Services, and attorney Douglas W. Davis ("Davis"), obtained life insurance policies through false

statements with the intention of selling those policies to third parties. (*Id.*) Christiana Trust, which held Fund I's Master Trust, was named as a defendant and received notice of the suit on April 20, 2010. (*Id.*)

119. In addition, Ohio National informed Christiana Trust that the owner and beneficiary change for this policy was being returned "unrecorded." (*Id.*)

120. Ohio National subsequently filed another lawsuit concerning the Joseph Griffin policy that contained similar allegations.

121. The two lawsuits had implications for the Funds not only relating to those two policies, but also to several of the other policies.

122. As with the policies at issue in the lawsuits, Jarkesy and JTCM had purchased other policies in 2007 and 2008 from defendant Paul Moraday, and the purchase agreements for those policies listed defendant Davis as the trustee for many of the insureds individuals' life insurance trusts. (*See, e.g.* DX-462; DX-466; DX-470).

123. In August 2010, Jarkesy wrote down the values of each of the David and Griffin policies to $100,000. (DX-404 at JTBOF 10693.) Jarkesy did not, however, write down the value of any of the other policies involving Paul Morady or Davis, notwithstanding the risk that many of those other policies would be voided due to fraud. (*See* DX-404.)

124. In connection with audit for the year ended December 31, 2010, Linda Ortiz ("Ortiz"), JTCM's Corporate Controller, informed MFR that based on the ongoing litigation, the values for the policies were written down to $100,000. (DX-337 at planning questionnaire.) Ortiz provided MFR with the Complaint for Declaratory Judgment, Damaged and Equitable Relief filed by Ohio National. (DX-337.)

125. Notwithstanding the risks that the Griffen and Davis policies were void due to fraud and were therefore worthless, MFR wrote the valuations back up. MFR informed Ortiz that because the court documents did not provide any basis for the exact write-down amount, and because the sole basis for the write-down was Jarkesy's own valuation (as opposed to a third-party valuation), the auditors were planning on writing the policies back up to the amortization schedule value. (DX-487.)

126. In March 2011, the policies were written back up to the value in the schedule. (DX-479 at JBTOF 20120.) This resulted in a material overstatement of Fund I's transferable life insurance policies recorded in Fund I's Statement of Assets and Liabilities as of December 31, 2010.

G. <u>The Undisclosed Role of Belesis and JTF in Fund Operations</u>

127. JTCM – acting through Jarkesy, its manager – represented that it was solely responsible for managing the Funds. The only disclosed connection between JTF and JTCM was JTF's role as placement agent and potential broker-dealer for the Funds' securities transactions. There was no disclosure that JTF or Belesis would become involved in JTCM's and the Funds' investment activities.

128. To underscore the independence of JTCM and JTF, JTCM's website included a disclaimer indicating that other than using JTF as a placement agent, JTCM had no business relationship with JTF.

129. Belesis, JTF and ATB were aware of the disclaimer distancing JTCM from JTF because Belesis used it as a model in an unrelated business venture.

130. In reality, Belesis frequently sought to intervene in the Funds' business decisions. In fact, the Fund copied Belesis as well as JTF's Chief Compliance Officer Castellano and other JTF employees on certain monthly account statements to investors.

131. As leverage, Belesis conveyed to Jarkesy – often in a profane and belligerent manner – that the millions of dollars invested into the Funds by JTF customers required Jarkesy to follow Belesis' instructions.

132. In light of his improper meddling in the Funds' business, Belesis separately indicated to registered representatives at JTF that the independence of JTCM and JTF on paper would be a helpful fact in the event anything improper happened with respect to the Funds.

133. For example, Belesis – sometimes, but not always, in collaboration with Jarkesy – periodically guided how the Funds' money would be invested in Galaxy Media. Galaxy Media's chief executive officer requested that Belesis allocate Fund money to pay operating costs, including rent, payroll and payments to Galaxy Media's service providers. The Funds' bank records show debits to pay certain Galaxy Media expenses.

134. In some cases, Belesis' decisions regarding Galaxy Media, one of the Funds' largest holdings, overrode the decisions of Galaxy Media's corporate officers, who implored him to handle Galaxy Media's affairs differently. As one example, Galaxy Media officers were displeased with Belesis' choice of chief financial officer for the company, who they thought required too high a salary.

135. As another example, Galaxy Media's officers complained that Belesis prematurely completed a stock purchase agreement that they had wanted to revise. However, Galaxy Media's officers had no choice but to accept Belesis' decisions about their

company because of Belesis' influence over when, how and if money would flow to Galaxy Media from the Funds, the company's main source of capital.

136. Belesis also supplanted Jarkesy as the decision maker for JTCM in connection with certain of the Funds' investments in Radiant Oil & Gas. Indeed, Belesis' role was clear when the Funds extended a bridge loan to Radiant Oil & Gas and the proceeds were delayed in arriving at the company. The company president and chief executive officer addressed Belesis – not Jarkesy, the supposed exclusive manager of the Funds – about the delay, and Belesis reassured him, *"You will have it, smoke a nice cigar."*

137. Numerous emails reflect Jarkesy's subservience to Belesis and efforts to please him by offering him benefits from the Funds' investment activities, including cash, fees and securities.

H. The Undisclosed Business Relationship between JTCM and JTF

138. In addition to the undisclosed influence Belesis exerted over the Funds' operations, JTCM and Jarkesy, despite publicly professing their independence from JTF, were in fact actively seeking to generate revenue for JTF and Belesis. For example, in March 2009, a JTCM employee wrote to Belesis:

> George [Jarkesy] and I have worked hard over the past month creating a backlog of potential clients for JTF and JTCM....We now have two or three that could be JTF clients in a matter of weeks with tens of thousands of dollars in monthly fees not to mention [another business transaction] already in the bag....
>
> The failure of your staff to execute payment on our contract has put a stop to our progress. . . . I still have high hopes for the potential of this liaison between JTF, JTCM ... and myself. Based upon your email below I estimate that you feel same. George, I know is optimistic of the potential that this relationship holds....

(DX 632).

139. In March 2009, the director of a company that JTCM and Jarkesy had steered to JTF asked to meet with Belesis before paying for JTF's services. In response, Belesis erupted at Jarkesy: "*GEORGE WHAT KIND OF BULL[...]T IS THIS*".

140. Jarkesy's reply indicates his allegiance to Belesis: "*I just told him to send the stock and money, sign the document or get lost*," he wrote. "*I think this will get done today. Nobody gets access to Tommy [Belesis] until they make us money!!!!!*"

I. **Jarkesy and JTCM Diverted the Funds' Money <u>to Enrich Belesis and JTF</u>**

141. Jarkesy and JTCM had various relationships with JTF and Belesis. First, JTF initially served as the chief placement agent and raised capital for the Funds. (RX-138 at 35:13-25). Second, JTF provided brokerage services for the Funds' securities transactions. (Jarkesy Tr. at 2634:3-7.) Third, JTF recommended to Jarkesy that the Funds provide bridge loans to certain companies. (RX-138 at 253:4-9 ("if [JTF] came across an opportunity that it believes would warrant the bridge fund having an opportunity to make a bridge loan, would do well for the [fund], [JTF] would refer that client to the [fund]"); DX-644.) Fourth, JTF served as investment banker to several of the Funds' portfolio companies, including three of the Funds' largest holdings: America West, Amber Ready/Galaxy, and Radiant Oil. (Tr. passim.)

142. As a result of these various arrangements, JTF earned millions of dollars in fees and commissions. In DX-505, the evidence indicates that JTF received $2,446,861.49 in placement fees for selling interests in the Funds, which is consistent with a 10 percent commission on total investments in the Funds of more than $24 million.

143. In DX-506, the evidence indicates that JTF received approximately $4.93 million in fees and commissions from investment banking and consulting agreements with the

Funds' portfolio companies. This figure does not include shares or warrants JTF also received from those portfolio companies.

144. The PPM stated that JTF "has been designated the selling agent for the Limited Partnership Interests, as well as one of the prime brokers for the Partnership. As such, [JTF] will earn commissions on the sale of Limited Partnership interests. In addition, [JTF] could earn brokerage and other fees (including soft dollars) from other investments purchased or sold through it." (DX-206 at 41.) JTCM's website also made representations about the relationship between the management company and the Funds and JTF:

> John Thomas Bridge and Opportunity Fund is not affiliated with John Thomas Financial. John Thomas Financial is a New York based Broker Dealer that is acting as a selling agent for the fund. No other relationship between the parties should be construed including that of owning, managing, directing or making any decisions for the fund. The fund operates pursuant to its board of directors and the fund's manager Mr. George Jarkesy.

(DX-502.)

145. Notwithstanding these disclosures, Jarkesy often acted in the interests of JTF and Belesis and promoted their interests over the interests of the Funds and their investors. This included maximizing JTF's and Belesis's fees (or failing to limit JTF's fees) even though Fund interests were better served by keeping JTF's fees as low as possible. (DX-122 at 298:19-24.)

146. Jarkesy was motivated to find additional compensation for JTF and Belesis under threat that if he didn't, JTF would stop selling interests in the Funds. (*See* DX-631 ("our relationship based on your actions is slowly coming to an end, you better f-****g take care of this today or it's over"); DX-643 ("per Tommy [Belesis] upon further notice here will no longer be any funds from John Thomas Financial clients into the bridge fund").)

147. Jarkesy's commitment to enriching JTF and Belesis enrichment is demonstrated in a March 2010 email from Jarkesy to Belesis, in which Jarkesy boasts to Belesis, "we are all

going to make so much f*****g money this year, the clients of John Thomas are going to have a banner year. Write yourself a check and get ready to cash it for $45 million." (DX-509.)

148. Jarkesy negotiated fees for JTF that JTF received in connection with bridge loans the Funds extended to small companies for which JTF served as investment banker. (RX 138 at 256:22-257:5.)

149. Moreover, Jarkesy took an active role in helping build JTF's investment banking business, including recommending JTF's services to the Funds' portfolio companies- despite the disclaimer on JTCM's website that it was independent from JTF. (*See* DX-502.)

150. Starting in February 2009, Jarkesy endeavored to develop investment banking clients for JTF with the help of Merrill Willgrubs ("Willgrubs"), a JTCM employee or consultant who worked with Jarkesy from JTCM's Houston, Texas office. (DX-632; RX-138 at 151:2-7.) One such company Jarkesy and Willgrubs approached was EnterConnect, a Fund I portfolio company. (DX-632.)

151. Jarkesy struggled to please Belesis in developing JTF's investment banking business. In February 2009, Willgrubs sent a draft engagement letter for EnterConnect to JTF's attorney and Jarkesy offered that potential investment banking relationship should be non-exclusive, "eat what you kill." (DX-645.) When Belesis requested to see a copy of the agreement, Willgrubs responded that "George [Jarkesy] is reviewing." (DX-507.) But when he finally got a copy of the document, Belesis complained that "this is not what I said to do." (*Id.*) "Then I misunderstood," Jarkesy replied. "I thought that you wanted a commission and your warrants." (*Id.*) Belesis pointed out that the agreement also included "consulting fees and other stuff," but Jarkesy promised to do better, stating: "Did you read carefully? It was very soft! We

will never retreat we will never surrender and we will always try to get you as much as possible. Every time without exception." (*Id.*)

152. Jarkesy continued negotiating the contract with EnterConnect through March 2009, including working with the company to finalize the investment banking agreement with JTF. (DX-631.) When a director of EnterConnect wanted to speak directly with Belesis, Jarkesy informed him that only he, Jarkesy, would be available to finalize the deal. (DX-646.) Belesis erupted when he heard the director wanted to speak with directly him, but Jarkesy assured Beleis, "I just told him to send the stock and money, sign the document or get lost, I think that this will get done today. Nobody gets access to Tommy until they make us money!!!!!" (DX-631.)

153. Jarkesy also negotiated with Hankings, a Chinese company and potential JTF investment banking and consulting client. (DX-524.) Once again, under the terms that Jarkesy-not Belesis or anyone else at JTF -was working to arrange, JTF was to receive $250,000 retainer, a scaling fee for mergers and acquisitions close, a thirteen percent commission on any equity financing that might be done in the future, and one percent of Hankings' equity when the company went public. (*Id.*) Meanwhile, during these negotiations that would have enriched JTF, JTCM's website disclaimed any relationship with JTF other than placement services and trade execution. (*See* DX-502.)

J. Jarkesy Breached his Fiduciary Duty to the Funds by Negotiating or Approving Investment Banking Agreements that were to the Funds' Detriment

154. Jarkesy, a director of America West, introduced the company to JTF. (Walker Tr. at 637:21-638:15.) In October 2008, Jarkesy, on behalf of America West, "basically negotiated the terms of [an exclusive investment banking] agreement directly with Mr. Belesis,"

according to Alexander Walker ("Walker"), another America West director who testified at the hearing in the SEC Action. (*Id.* at 642:3-6.) Under the terms of the agreement, which related to America West's sale of America West common stock, JTF was to receive a commission of thirteen percent on all funds raised in the sale, plus warrants to purchase 15 million shares at $0.01 per share. (DX-348 at 11 of 28; Walker Tr. at 638:17-25; America West Form 10-K for year ended December 31, 2009.) In addition, the agreement Jarkesy negotiated with JTF also required America West to use JTF for other services, including insurance, consulting, and brokerage services for some of the officers of the company. (Walker Tr. at 639:2-17.) From 2008 through 2011, when JTF provided services to America West, Walker testified that the fees Jarkesy had negotiated were high and included a lot of "add-ons." (*Id.* at 641:9-15). Jarkesy made no effort to negotiate lower fees (DX-122 at 298:19-299:5), nor did he negotiate a non-exclusive agreement, as he had for other companies, which left America West no alternative but to pay JTF's high fees (*see* DX-645.)

155. Belesis also threatened to withhold money that JTF had raised in a private placement unless he received 10 million additional shares of America West owned by Walker. (Walker Tr. at 648:5-649:2.) When Walker complained to Jarkesy, Jarkesy replied: "It is what it is." (*Id.* at 649:12-16.) Ultimately, the company stepped in and issued more shares to JTF, which diluted the value of the outstanding shares- including those held by the Funds. (*Id.* at 650:18-651:11.)

156. Correspondence between Jarkesy and Belesis indicates that Jarkesy sought to maximize the fees America West paid to JTF, to the detriment of America West, and in breach of Jarkesy's duty to the Funds, which were invested in the company Jarkesy was harming. In May 2009, Jarkesy wrote Belesis with respect to a $5.4 million round of financing, "I think that we

can make JTF the hero by getting the company to reprice the warrants at $0.05 cents." (DX-511.) Jarkesy noted that this would "generate $90,000 in commissions [for JTF] plus maybe you could get 3 months of IB fees paid at closing." (*Id.*)

157. Disappointed with JTF's services, America West fired the firm at least twice. (DX 122 at 152:25-153:4.) Jarkesy and Belesis fought incessantly (DX-122 at 135:15-16), and "butted heads" over Belesis' failure to raise the money that he promised, (*id.* at 143:10-17). Jarkesy used America West and the Funds to generate fees for JTF, even when JTF did nothing to earn those fees.

158. For example, effective July 14, 2011, the Funds converted $500,000 of America West debt into equity, yielding a commission to JTF of $65,000. (DX-312.) Belesis confirmed that JTF did nothing for the fee; JTF received the fee because Jarkesy negotiated it. (RX-138 at 272:6-15.)

159. JTF also received commissions for money that the Funds invested in America West, despite having no involvement in the transaction. (DX-638.) Jarkesy admitted that JTF was paid commissions on some loans that Jarkesy negotiated directly with America West without any involvement from JTF. (Jarkesy, Tr. 2190:18-2191:2).

160. In addition to the tribute Jarkesy paid JTF by negotiating high fees from America West, Jarkesy was a director of Radiant in August 2010 when it entered into an investment banking agreement under terms that heavily favored JTF. Jarkesy introduced Radiant to JTF. (Jarkesy, Tr. 2217:24-2218:2). Under the terms of the agreement, JTF would be the placement agent for a series of Radiant private offerings up to $14,500,000 on a best-efforts basis. (DX-310 at 32.) Remarkably, the terms included Radiant issuing JTF three million shares of its stock in consideration to JTF for entering into the agreement. The issuance immediately

gave JTF control of nearly a quarter of Radiant's shares and made JTF the second largest shareholder- even larger than the Funds. (DX-310 at 41.) The issuance of these shares, and the disproportionate position it provided JTF, prompted Radiant to warn in its public filing that it "may be considered an overhang on the market and could depress any market that may develop for the Company common stock as well as the offering price of our equity securities in subsequent financings." (DX-310 at 19.)

161. In addition to the immediate issuance of 3 million shares of Radiant, the investment banking agreement Jarkesy negotiated provided that JTF would receive thirteen percent of the gross proceeds of any equity offerings and a sliding percentage of all money raised in debt offerings. Moreover, it provided that JTF would receive two percent of the cash proceeds of any additional financing that Radiant might obtain from Macquarie Bank- the same bank that had been providing Radiant financing since at least September 2006. (DX-310 at 32, 30.)

162. As the general partner of the Funds, and a director of Radiant, one of the Funds' portfolio companies, Jarkesy breached his fiduciary duty by allowing Radiant to agree to such unfavorable terms with JTF. (*See* DX-310; DX-206; DX-210.) The investment banking agreement Jarkesy negotiated was to Radiant's detriment, and thus to the detriment of the Funds, which were one of Radiant's largest shareholders. (*See id.*) Yet, as with the America West negotiations, Jarkesy used his position as a director of Radiant and manager of the Funds to enrich JTF and Belesis in breach of his fiduciary duty. (*See id.*)

163. Jarkesy was also involved in the negotiations of the investment banking agreement between Galaxy and JTF following the merger, pursuant to which JTF was going to receive 1% of Galaxy's gross revenues. (DX-660).

K. Contrary to What He Told Investors, Jarkesy Delegated Authority to Belesis

164. Walker, the America West director who testified at the hearing in the SEC Action, was shocked to learn in 2012 that contrary to previous representations, Jarkesy's and JTCM's independence from JTF was in doubt, and that Jarkesy and JTF were "tied at the hip." (Walker Tr. at 657:8-14, 658:5-21.)

165. For years prior to that, America West had represented in its filings with the Commission, in reliance on Respondents' representations, that JTF and the Funds were not affiliates of each other and that JTF had no direct or indirect ownership or management interest in the Funds. (DX-311 at 46.) However, in late 2011 and early 2012, America West discovered its disclosure was inaccurate. At the time, America West determined it would be forced to suspend payments to royalty holders, including Fund I, due to liquidity issues. (Walker Tr. at 655:4-20.) During a conference call to discuss the royalty payments, Walker testified that he expressed concern that Jarkesy was not on the call to represent Fund I's interest. (*Id.* at 656:10-657:7.) A representative from JTF who was on the call told him, "don't worry. I talked to [Jarkesy] about it over the weekend. We are partners with him on the investment in America West and other investments and ... we are tied at the hip at this." (*Id.* at 657:8-14.)

166. Walker testified at the SEC hearing that he was shocked and concerned about this statement because this was the first time that someone had mentioned a partnership or other integral relationship between the Funds and JTF. (Walker Tr. at 658:5-21.) Moreover, Walker and America West had relied on Jarkesy to "play point on our relationship with [JTF] and to protect the interests of the company;" with the new understanding of JTF and Jarkesy's relationship, he testified that he understood there might be a conflict of interest. (*Id.* at 660:4-12.) Jarkesy, who as a director of America West had signed the company's filings with the Commission discussing JTF and the Funds' independence, dismissed Walker's concerns. (*Id.* at

661:14-17; DX-311 at 50.) But Walker made sure America West disclosed the new information in its Form 10-K that year: "In 2012, we also have been informed that certain affiliates of [JTF] may have a direct or indirect ownership interest in [Fund I or Fund II]. We have no information as to when such a relationship, if it exists, was created." (DX-346 at 48.)

167. The undisclosed relationship between JTF and Respondents also was evident in Belesis' control over the Funds' investment in Galaxy. Savage, Galaxy's former chief financial officer, testified at the hearing in the SEC Action that "everything that we did financially was always a discussion or many discussions between Mr. Jarkesy and Mr. Belesis" and Galaxy personnel observed that Jarkesy and Belesis worked together controlling the company. (Savage Tr. at 1567:14-1568:6.)

168. Belesis told Savage that Belesis would be making decisions for the company, along with Jarkesy, and that Belesis could convince Jarkesy to do anything. (*Id.* at 1577:8-24.) Belesis' decisions included re-routing funding from Galaxy's marketing to the Amber Ready part of the business. (*Id.* at 1565:11-1566:20.) Belesis and Jarkesy decided together to install a chief financial officer at Galaxy over Savage's objections. (*Id.* at 1572:6-16, 1574:5-1575:15; DX-516.) Belesis also removed certain directors from Galaxy's board, with Jarkesy's approval. (Id. at 1578:10-24.) Savage testified that Belesis promised him that the Funds would pay for Galaxy's operational expenses, and when the payments were not made, Belesis called Jarkesy repeatedly to make sure the funding came through. (*Id.* at 1582:16-1583:13.)

169. Far from being independent of Belesis, Jarkesy took instructions from Belesis as to whether, when, and how to fund Amber Ready and Galaxy. For example, on December 17, 2009, Frank DelVecchio, Amber's chief executive officer, wrote to Belesis and Jarkesy, concerned that Amber would be unable to meet its payroll obligations the next day. (DX-513.)

170. In response to inquiries about the company obtaining a bridge loan from the Funds, Belesis told Jarkesy "get frank the bridge ASAP." (DX-513.) The next day, the Funds bought $40,000 worth of stock in the company. (DX-314 at 15.)

171. Belesis' influence continued after Amber became part of Galaxy in 2010. In October 2010, Belesis instructed Jarkesy to send money to Galaxy to pay essential expenses, and Plumb, Galaxy's chief financial officer, instructed Villa, Jarkesy's assistant, that Belesis wanted Fund money to be wired to a Galaxy consultant. (DX-518, DX-520.) Belesis followed up, sending several emails to Villa and Jarkesy demanding that the wires be sent. (DX-639.) "George what are you doing. Give Patty the okay," Belesis wrote to Jarkesy. (*Id.*) Villa, in turn wrote to Jarkesy: "Money needs to go now. Tommy is all over me!" (*Id.*) A few weeks later, Belesis promised Galaxy's attorney that he would be paid $49,000 from the Funds for work done on Galaxy's registration statement. (DX-521.) Jarkesy confirmed that the attorney would receive the wire, and wired the money within a few days. (DX-664.)

L. Jarkesy Continues to Materially Misrepresent the Funds' Largest Positions.

172. In June 2011, the SEC staff sent the first of several investigative subpoenas to the Funds and JTCM. (DX-617.) The first subpoena requested documents sufficient to identify all assets of the Funds for each month and "all documents concerning valuation" of certain assets of the Funds, including America West, Amber/Galaxy and Radiant. (*Id.*) Shortly after receiving the subpoenas, in August 2011, Jarkesy sent a letter to the investors that contained various misrepresentations about portfolio companies. (DX-240.)

173. In Jarkesy's letter to investors of August 2011, he noted the volatility and the wild swings in the Funds' values and "highlight[ed] a few things for you to consider about your ownership in the John Thomas Bridge and Opportunity Fund, 1 and 2." (DX-240.) He wrote

that the Funds had a "very large position" in America West and that the swing in its stock price during the year from $2.80 to $0.50 was "the main cause of the large movements in your monthly statements." Jarkesy noted, however, that America West had just reported three consecutive quarters of revenue growth and stated his belief that "the underlying assets of the company are valuable and will be more so in an inflationary environment." (*Id.*)

174. Yet, Jarkesy left out material information in the letter to the investors, including that America West: 1) had recently disclosed that it had defaulted on loan obligations; 2) lacked sufficient cash flows to meet obligations; 3) was issued a going concern opinion by its auditors; 4) had an eighty-five percent increase in net losses in fiscal year 2010; and 5) had determined its internal controls were inadequate to ensure the accuracy of its financial statements. (DX-311.) None of these developments was in Jarkesy's letter. (*See* DX-240.)

175. Jarkesy's August 2011 letter further noted that the Funds had just made their first distribution of proceeds from a life settlement policy, which paid a benefit upon the death of one of the insureds. (DX-240.) Jarkesy wrote that "we are adding more policies in the portfolio (we make offers regularly)." (*Id.*) Jarkesy did not disclose, however, that the Fund had not added a new life settlement policy to the portfolio in more than two years. Moreover, while Jarkesy's letter noted that the Fund owned policies that had been issued by Ohio National, he failed to disclose that Ohio National had sued to invalidate several of these policies.

176. Regarding the Funds' investment in Radiant, Jarkesy wrote to investors that he "believe[d] this company has valuable assets, strong management and if it can raise additional capital, they will be successful at growing this company by the drill bit and through acquisition." (DX-240, emphasis added.)

177. However, Jarkesy failed to disclose to Fund investors that Radiant had failed to timely file its Form 10-K for the year ending December 31, 2010 (DX-349); that the company had failed to timely file its Form 10-Q for the quarter ended March 31, 2011 (DX-350); or that its stock had been delisted from the OTCBB due to the late filings (DX-351). Jarkesy also omitted from his letter to Fund investors that when Radiant filed its Form 10-K, it disclosed that there were pervasive control deficiencies in the company's financial reporting disclosure controls, resulting "in a reasonable possibility that material misstatements of the financial statements will not be prevented or detected ...." (DX-310 at 35.)

M. Respondents Failed to Wind Up the Fund on Time

178. Jareksy designed Fund I to wind up by September 2012. (DX-234.) Quarterly reviews Jareksy sent to investors made clear that the Fund would continue for twenty quarters, or five years after commencing operations in the summer of2007. (DX-214 at AM_SEC00007177 ("[o]ur first of twenty quarters together as partners has come and gone"); DX-215 at AM_SEC00012288 ("[o]ur second of twenty of quarters together as partners has come and gone").

179. In March 2012, Jarkesy wrote to Fund I investors that "it is my intention to wrap up the Fund in accordance with the partnership agreements as quickly as possible this year, thereby reducing the need for our Fund to continue to incur full operational expenses." (DX-234.) Jarkesy represented in his letter that JTCM was in the process of gathering updated medical information about the insureds whose policies were in the life settlement portfolio, and was "in the process of obtaining bids on policies" and "working on collecting loans that were outstanding and liquidating positions that we have on our books." (*Id.*) Jarkesy further informed investors that he had resigned from America West's board of directors so he could liquidate or distribute

shares. (*Id.*) Jarkesy told the Fund investors that all assets would be distributed in 2012 except for the life settlement policies, the cash to pay the premiums on the life settlement policies, royalties for America West, and some legal claims. (*Id.*) Finally, Jarkesy wrote that Respondents would distribute K-1 and audited financial statements. (*Id.*)

180. In 2013, a year after describing how he would wind up Fund I in 2012, Jarkesy sent an email to the investors in Fund I advising that "pursuant to Section 11.1 of the Amended and Restated Agreement of Limited Partnership ... [JTCM] hereby elects to dissolve the partnership" effective March 13, 2013. (DX-242.) Upon dissolving the partnership, the Limited Partnership Agreement required that the Respondents "use all commercially reasonable efforts to sell all of the Partnership's assets in an orderly manner." (DX-206 at 31.)

181. Despite Jarkesy's promise to wind up Fund I in 2012, and despite Respondents' dissolution of the partnership in 2013, Jarkesy and JTCM still have not distributed the assets of the Funds to the investors, in violation of the Limited Partnership Agreement. (*See* DX-203 at 31.) The only asset that has been distributed are some shares of Radiant that have a restricted legend. (*E.g.*,DX-247.) Jarkesy testified, however, that he has not even distributed all of the shares of Radiant; he is holding some back, hoping for a better price. (Jarkesy, Tr. 1314:20-1315:4). Other than the few remaining shares of Radiant, and a single life settlement policy, Jarkesy could not identify or value any other asset held by the Funds. (Jarkesy, Tr. 63:15-16).

N. Jarkesy and JTCM Earned Significant Fees

182. Jarkesy and JTCM received approximately $1.3 million in fees for managing the Funds. The figure includes $337,336 for 2007-2008 (DX-315 at F7); $363,695 for 2009 (DX-316 at F8); $509,348 from Fund I for 2010 (DX-317 at JTBOF 06292); and $68,897 from Fund

II for 2009-2010 (DX-318 at JTBOF 06304). Jarkesy and JTCM also received $260,000 in incentive fees from Fund 2.

O. MFR's and Padilla's Wrongful Conduct

183. The breach of fiduciary duties alleged above could not have occurred without the substantial participation of MFR.

184. As alleged below, the financial statements issued by Fund I for the year ended December 31, 2010 and 2009, and issued by Fund II for the year ended December 31, 2010 were materially false and misleading when issued because the financial statements failed to comply with accounting principles generally accepted in the United States ("GAAP"), causing those financial statements to materially overstate the Fund's assets, partners' capital and results of operations.

185. GAAP are those authoritative principles and standards recognized by the Financial Accounting Standards Board ("FASB") to be applied in the preparation of financial statements issued in conformity with GAAP.

186. Under FASB Statement of Financial Accounting Concepts 1: Objectives of Financial Reporting by Business Enterprises, financial reporting

> a. (i) should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensive to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence;
>
> b. (ii) should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. Since investors' and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash flows to the related enterprise; and

c. (iii) should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change its resources and claims to those resources.

187. Specifically, Fund I's and Fund II's Statement of Assets and Liabilities and Schedule of Investments for 2009 and 2010 materially overstated the reported values of, among others, the common stock of American West Resources, Inc., Radiant Oil & Gas, Inc., Sahara Media Holdings, Inc., transferable insurance policies, and promissory notes, thereby materially overstating the Funds results of operations and partners' capital.

188. For example, Fund I's 2010 financial statements represented that:

> The Partnership records its investments at fair value. Investments in interest-bearing and equity securities are recorded at fair value as determined in good faith by the General Partner in a manner consistent with the Partnership's written guidelines in the Limited Partnership Agreement.
>
> The Partnership has investments in life insurance policies at December 31, 2008, 2009 and 2010. The values have been estimated by the General Partner using a life expectancy model (Milliman) to determine the fair market value in the absence of readily ascertainable market values. Because of the inherent uncertainty of valuation, the estimated values may differ from the values that would have been used had a ready market existed for the securities and differences could be material.
>
> The Partnership has investments in promissory note at December 31, 2008, 2009 and 2010. The values are recorded at fair value in accordance with the terms of the contract agreement.

189. A nonregistered investment company, such as the Funds, were required by GAAP to categorize and disclose the following for its investments:

a. Categorize investments by all of the following:
   1. Type (such common stocks, preferred stocks, convertible securities, fixed-income securities, government securities, options purchased, options written, warrants, futures, loan participations, short sales, other investment companies, and so forth).
   2. Country of geographic region, except for derivative instruments for which the underlying is not a security.
   3. Industry, except for derivative instruments for which the underlying is not a security.

4. For derivative instruments for which the underlying is not a security, by broad category of underlying (for example, grains and feeds, fibers and textiles, foreign currency, or equity indexes) in place of categories.

b. Report the percent of net assets that each such category represents and the total value and cost for each category.

c. Disclose the name, shares or principal amount, value, and type of both of the following:
   1. Each investment (including short sales) constituting more than 5 percent of net assets, except for derivative instruments (see (3) and (f)). In applying the 5-percent test, total long and total short positions in any one issuer should be considered separately.
   2. All investments in any one issuer aggregating more than 5 percent of net assets, except for derivative instruments (see (e) and (f). In applying the 5-percent test, total long and total short positions in any one issuer shall be considered separately.

d. Aggregate other investments (each of which is 5 percent or less of net assets) without specifically identifying the issuers of such investments, and categorize them in accordance with the guidance in (a). In applying the 5-percent test, total long and total short positions in any one issuer shall be considered separately...

e. Provide both of the following additional qualitative descriptions for each investment in another nonregistered investment partnership whose fair value constitutes more than 5 percent of net assets:
   1. The investment objective
   2. Restrictions on redemption (that is, liquidity provisions).

190. Furthermore, an investment company, such as the Funds, must disclose all of the following:

a. Either in the body of the financial statements or in the accompanying notes, the fair value of financial instruments for which it is practicable to estimate that value.

b. The method(s) and significant assumptions used to estimate the fair value of financial instruments consistent with the requirements of paragraph 820-10-50-2(bbb) except that a reporting entity is not required to provide the quantitative disclosures about significant unobservable inputs used in fair value measurements categorized within Level 3 of the fair value hierarchy required by that paragraph.

c. A description of the changes in the method(s) and significant assumptions used to estimate the fair value of the financial instruments, if any, during the period.

d. The level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2, or 3).

191. Of particular importance in the financial statements of an investment company is the application and disclosure of the fair value hierarchy known as Level 1, 2, or 3 under GAAP. As established by the issuance of SFAS No. 157, [4] which required the Funds to adjust the

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[4] Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available,...In some situations, a quoted price in an active market might not represent fair value at the measurement date. That might be the case if, for example, significant events (principal-to-principal transactions, brokered trades, or announcements) occur after the close of market but before the measurement date...

Level 2 inputs are inputs other than quoted prices included with Level 1 that are observable for the asset or liability, either directly or indirectly... Level 2 inputs include the following: a. Quoted prices for similar assets or liabilities in active markets. b. Quoted prices for identical or similar assets or liabilities in markets that are not active. c. Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates). d. Inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs). Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability...An adjustment that is significant to the fair value measurement in its entirety might render the measurement a Level 3 measurement, depending on the level in the fair value hierarchy within which the inputs used to determine the adjustment fall. The reporting entity should evaluate the following factors to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability when compared with normal market activity for the asset or liability (or similar assets or liabilities). The factors include, but are not limited to: a. There are few recent transactions. b. Price quotations are not based on current information. c. Price quotations vary substantially either over time or among market makers (for example, some brokered markets). d. Indexes that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability. e. There is a significant increase in implied liquidity risk premiums, yields, or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the reporting entity's estimate of expected cash flows, considering all available market data about credit and other nonperformance risk for the asset or liability. f. There is a wide bid-ask spread or significant increase in the bid-ask spread. g. There is a significant decline or absence of a market for new issuances (that is, a primary market) for the asset or liability or similar assets or liabilities. h. Little information is released publicly (for example, a principal-to-principal market). The reporting entity shall evaluate the significance and relevance of the factors to determine whether, based on the weight of the evidence, there has been a significant decrease in the volume and level of activity for the asset or liability. If the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), transactions or quoted prices may not be determinative of fair value (for example, there may be increased instances of transactions or quoted prices may be necessary to estimate fair value in accordance with this Statement. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions...

Circumstances that may indicate that a transaction is not orderly include, but are not limited to: a. There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions. b. There purported quoted market price for the thinly traded inactive common stocks to reflect estimated fair value considering all the facts and circumstances known to defendants. Fair value is the price that would be received by the Funds to sell the assets.

192. The December 31, 2009 and 2010 financial statements contained an unqualified opinion from Fund I's auditor, Defendant MFR. MFR provided an unqualified opinion for Fund II's financial statements for the year ended December 31, 2010.

193. For each year MFR represented that it had audited the financial statements of the Fund in accordance GAAS with auditing standards generally accepted in the United States of America ("GAAS") and that in MFR's opinion the financial statements at each date presented fairly, in all material respects, the financial position and results of operations of the Fund in conformity with accounting principles generally accepted in the United States of America.

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was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant. c. The seller is in near bankruptcy or receivership (that is, distressed), or the seller was required to sell to meet regulatory or legal requirements (that is, forced). d. The transaction price is an outlier when compared with other recent transactions for the same or similar asset or liability. The reporting entity shall evaluate the circumstances to determine whether the transaction is orderly based on the weight of the evidence ...

Regardless of the valuation technique(s) used, the reporting entity shall include appropriate risk adjustments. However, when there has been a significant decrease in the volume or level of activity for the asset or liability, the reporting entity should evaluate whether those quoted prices are based on current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risks). In weighting a quoted price as an input to fair value measurement, the reporting entity should place less weight (when compared with other indications of fair value that are based on transactions) on quotes that do not reflect the result of transactions.

Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of a market participant that holds the asset or owed the liability. Therefore, unobservable inputs shall reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data.

194. These representations were materially false and misleading for the reasons set forth herein. MFR and Padilla recklessly failed to perform its audits of the Fund in accordance with GAAS and knew or recklessly ignored red flags for the following reasons:

(a) MFR failed to exercise due professional care in the performance of its audits [AU §230]. [5]

(b) MFR failed to perform its audit procedures with a consideration of audit risk for material account balances and transactions related to investments. [AU§312].

(c) MFR failed to obtain the necessary information and perform the audit to identify the risks of material misstatement due to fraud. [AU §316].

(d) MFR failed to obtain sufficient appropriate audit evidence to provide reasonable assurance that fair value measurements and disclosures are in conformity with GAAP. [AU §328].

(e) Failed to identify and properly disclose related parties that were known to MFR or were recklessly disregarded by MFR. [AU §334].

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[5] Due professional care requires the auditor exercise *professional skepticism*. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor uses the knowledge, skill, and ability called for by the profession of public accounting to diligently perform, in good faith and with integrity, the gathering and objective evaluation of evidence.

Gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence. Since evidence is gathered and evaluated throughout the audit, professional skepticism should be exercised throughout the audit process.

While exercising due professional care, the auditor must plan and perform the audit to obtain sufficient appropriate audit evidence so that audit risk will be limited to a low level that is, in his or her professional judgment, appropriate for expressing an opinion on the financial statements. The high, but no absolute level of assurance that is intended to be obtained by the auditor is expressed in the auditor's report as obtaining reasonable assurance about whether the financial statements are free of material misstatement (whether caused by error or fraud). Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, an audit conducted in accordance with generally accepted auditing standards may not detect a material misstatement.

The independent auditor's objective is to obtain sufficient appropriate audit evidence to provide him or her with reasonable basis for forming an opinion. The nature of most evidence derives, in part, from the concept of selective testing of the data being audited, which involves judgment regarding both the areas to be tested and the nature, timing, and extent of the tests to be performed.

(f) Failed to utilize a specialist to evaluate the life insurance policy valuation as the auditor's education and experience did not have the expertise to perform and/or evaluate such valuations. [AU §336].

(g) MFR failed to understand the Funds and their environment and assessing the risks of material misstatement. [AU § 314]. The audit of a company's investment accounts is a significant portion of the overall audit because of the relative significance of those accounts and related income accounts. As set forth in the AICPA Audit and Accounting Guide for Investment Companies: The principal objectives in auditing the investment accounts are to provide reasonable assurance of the following:

(I) The investment company has ownership of, and accounting control over, all its portfolio investments.

(II) All transactions are authorized and recorded in the accounting records in the proper account, amount and period.

(III) Portfolio investments are valued properly, and their costs are recorded properly.

(IV) Income from investments and realized gains and losses from securities transactions are accounted for properly.

(V) Investments are free of liens, pledges, or other security interests, or if not, such matters are identified properly and disclosed in the financial statements

195. Defendant Juan Padilla was the partner in charge of MFR's audits of Fund I for the years ended December 31, 2008, 2009 and 2010, and audit for Fund II from inception through December 31, 2010.

196. Mr. Padilla had no experience auditing hedge funds. May 22, 2012 SEC Tr. at 31:23-25.

197. By way of example, MFR knew or should have known that as a public company America West files forms 10-K and 10-Q with the SEC.

198. As of December 31, 2008 approximately 33% of Fund I's assets were invested in America West securities and as of December 31, 2010, approximately 25% of Fund I's assets were invested in America West securities.

199. On April 15, 2011 before the issuance of the Fund's 2010 financial statements and before MFR's audit report, America West filed its SEC Form 10-K for the year ended December 31, 2010.

200. America West's independent auditor's report therein was qualified as to the fact that there existed substantial doubt about America West's ability to continue as a going concern.

201. The financial statements of America West reported a shareholders' deficit of $9.1 million with assets of $23.5 million, and a net loss for the year of $16.1 million.

202. America West disclosed "the market for our common stock on the OTC Bulletin Board is limited, sporadic and highly volatile."

203. America West had in excess of 40 million shares issued and its trading volume in late 2010 was approximately 10,000 shares per week.

204. America West disclosed in its Form 10-K that its market value of the voting stock held by non-affiliates was $23.8 million.

205. On March 31, 2011 Fund I had to convert $3.0 million of its debt in exchange for 3 million shares of common stock because America West could not pay off the matured debt.

206. A material amount of the Funds' investment in America West was "restricted" stock which would significantly reduce its fair value and preclude it from being valued the same as unrestricted common stock. Defendant Padilla testified that he could not think of a scenario where free-trading stock would be valued the same as restricted stock:

> Q Does it make - I mean getting away from the piece of paper, does it make sense to you that a stock that is restricted is valued the same as a stock that's free trading?
>
> A I guess looking at it now, I would have to go back and look at all the flags and why we went that way.
>
> Q Well, I mean even if you didn't know, just any stock, does it make sense that a free trading - is there a scenario you could think of where a free trading stock would have the same value as one that's restricted?
>
> A I can't think of a scenario.

May 22, 2012 SEC Tr. at 85:20-86:04.

207. However, that is exactly what Defendants Padilla and MFR did. Most of Fund I's investment in America West was "restricted" stock which would significantly reduce its fair value and preclude it from being valued the same as unrestricted common stock.

208. MFR, ignoring red flags and/or failing to exercise professional skepticism, allowed the Fund I to report that its investment in America West had a fair value of over $7.0 million. MFR allowed Fund II to report that its investment in America West was worth approximately $2.6 million. In truth, the Funds' investments in American West securities were nearly worthless.

209. Furthermore, in violation of GAAP, JTCM and Jarkesy failed to disclose in Fund I's December 31, 2010 financial statements that at March 31, 2011 it converted most if not all of the outstanding delinquent note receivable from America West into common stock.

210. Defendant Padilla testified that he knew Defendant Jarkesy was a board member of America West, and that the LPA provided Defendant Jarkesy discretion in valuing the Funds' assets, but he failed to check America West's SEC filings in connection with MFR's audit:

Q But you were aware that he had a role in America West?

A We were aware of it.

Q And that didn't cause you in some way to question the valuations of these short term funds?

A He was a board member, no. . . .

Q Do you recall reviewing public filings of America West in your audit process?

A No, we did not review public filings. We looked at what the fund managers [sic] and then tested it to the program.

Q So if it was disclosed in a public filing that America West had defaulted on one or more of these loans, you wouldn't have picked that up in the process?

A No, because we didn't review the 10K . . . .

Q Is there a reason you didn't review the company's public filings?

A We didn't think it was necessary as part of our audit.

May 22, 2012 SEC Tr. at 83:1-84:13.

211. Had MFR and Padilla conducted the audit of the Funds in accordance with GAAS and reviewed America West's 2010 10-K, they would have observed that with respect to certain Notes that the Funds reported as valuable assets, America West had defaulted:

Q I understand you say that you didn't look at the 10K's. Let me show you what was marked as Exhibit 34, which is the 10K for America West for the period ended 12/31/2010. Let me direct you to page F15.

A Okay.

Q Do you see under note 9, related party transactions?

A Yes, ma'am.

Q There's the discussion of an $805,000 loan that the company took out. . . . Do you see where it says that America West defaulted on that loan? The loan is "As of December 31, 2009, America West defaulted on this loan." . . . .

Q Does it appear to you that in its holding statement of December 31st, 2010, the fund is listing an $805,000 loan that the company reports it had defaulted on?

A. That's what it appears to, yes.

Q But that's not something that MFR looked at during the course of its audit?

A No, we did not look at the 10K.

May 22, 2012 SEC Tr. at 88:3-89:5.

212. Padilla further testified had he known that America West defaulted on the loan, that would have changed the valuation of this asset on the loan balance sheet. May 22, 2012 SEC Tr. at 90:8-14.

213. As to Radiant Oil another publicly-held company which filed its SEC Form 10-K for 2010 on April 15, 2011 prior to the issuance of MFR's audit report on the financial statements of the Fund on April 27, 2011, Radiant Oil's financial statements were qualified because as of December 31, 2010 "the Company has recurring losses from operations and has a working capital deficit. These factors raise substantial doubt about its ability to continue as a going concern." Radiant reported a shareholders' deficit at December 31, 2010 of $3.35 million with total assets of only $3.75 million; and a working capital deficit of $5.78 million.

214. At December 31, 2010 Fund I reported a fair value of $6.9 million for Radiant, which since the Fund owned 17% of Radiant would equate to a market value of Radiant in excess of $40 million. Radiant Oil's trading volume at December 31, 2010 was based on 800

shares being traded in almost two months. In fact, Radiant's SEC Form 10-K disclosed that "the market for our common stock on the OTCBB is limited, sporadic and highly volatile."

215. At the time MFR issued its audit report on the Fund Radiant stock was trading 200 to 300 shares per month.

216. That is not an active market that provided MFR a reasonable basis for allowing the Fund to report a value of $6.9 million for Radiant.

217. Radiant disclosed that there "is no public market for our common stock, and there can be no assurance that any public market will develop in the foreseeable future. Transfer of our common stock may also be restricted under the securities regulations and laws promulgated by various states and foreign jurisdictions, commonly referred to as "Blue Sky" laws. Absent compliance with such individual state laws, our common stock may not be traded in such jurisdictions. Because the securities registered hereunder have not been registered for resale under the Blue Sky laws of any state, the holders of such shares and persons who desire to purchase them in any trading market that might develop in the future, should be aware that there may be significant state Blue Sky law restrictions upon the ability of investors to sell the securities and of purchasers to purchase the securities. These restrictions prohibit the secondary trading of our common stock."

218. Additionally, within Radiant's SEC Form 10-K, Radiant valued its common stock at $1.00 per share, which at most equates to a value of the shares owned by the Fund of $2.2 million not $6.9 million.

219. Defendant Padilla testified that he knew Radiant Oil was a thinly traded micro-cap stock (May 22, 2012 SEC Tr. at 98:4-7) and was aware of facts that put him on notice that

Defendant Jarkesy was arbitrarily valuing the Funds' holdings of Radiant Oil common stock and warrants.

220. Defendant Padilla was aware that in September 2010, Jarkesy valued Radiant Oil shares in Fund 1 at $0.22 per share, and valued Radiant Oil shares at $1 per share in Fund II, and further testified that such valuations were baseless:

> Q. Do you have any idea how you could sell shares from one fund to the other at 22 cents and then value them at $1 once they arrived in the second fund?
>
> A You couldn't.
>
> Q Why not? . . . .
>
> A Well, you can't have the same value for one fund at the same - for the same company at the same time, the same date.
>
> Q Because it's inappropriate in your view to value the same security consistently between two funds, correct?
>
> A Correct.

May 22, 2012 SEC tr. at 92:13-24.

221. Knowing that Jarkesy used different valuations for the same stock, and that Radiant Oil was a thinly traded micro-cap stock, Defendants MFR and Padilla nevertheless determined that Defendant Jarkesy properly valued Radiant Oil stock at $4 per share:

> Q And at the end of the year do you recall any discussion or controversy over the value of the Radiant position?
>
> A No, I think they were valued at the same price on both funds. I can't remember if - I can't remember on Fund what they were valued, but I'm pretty sure it was the same value.
>
> Q Radiant was at the time a rather thinly traded micro cap stock, is that your understanding?
>
> A I believe that's the way we recorded it.

Q So when your team went to Yahoo or Bloomberg to verify the price as of year end and saw $4 . . . . Did that generate any discussion internally, that being the rather high share price for a thinly traded penny stock?

A. I don't recall having that discussion specifically and I don't recall when was the last time it was traded. I thought we had documented when the last trade happened.

Q I understand that your job was mechanically to look at the share price from an objective source, I understand that, but if you look at the trading price history of the stock, let's face it at a few months it goes from basically nothing, sub penny or penny range to $4. Do you have any insider knowledge into how that happened?

A No, I don't.

Q Was that ever a concern to you the steep rise in the trading price of the security?

A No, we didn't remember having a discussion around that.

Q Do you recall reading public filings of Radiant?

A No, we did not review any public filings for any of the public companies.

May 22, 2012 SEC tr. at 97:12-99:7.

222. As of December 31, 2010, 25% of Fund I's assets were invested in Radiant Oil. As of December 31, 2010, 21% of Fund II's assets were invested in Radiant Oil. Also at that time, Defendant Jarkesy was a director of Radiant, a position he held since August 2010. Previously Defendant Jarkesy served as chairman of the board and chief executive officer of Radiant Oil from August 15, 2006 through June 15, 2007.

223. Defendant Padilla did not review Radiant Oil's SEC filings:

Q Do you recall reading any public filings of Radiant?

A. No, we did not review any public filings for any of the public companies.

May 22, 2012 SEC Tr. at 99:4-7.

224. Defendant Padilla testified that he was unaware that Jarkesy was a director or Radiant Oil. May 22, 2012 SEC Tr. at 82:6-8. Had Mr. Padilla reviewed Radiant Oil's 10-K for the year ended December 31, 2010, he would have known that Defendant Jarkesy was a director of Radiant Oil.

225. Both the SEC forms 10-K for America West and Radiant disclosed that Fund I was a related party. Yet in the Funds financial statements there was no such disclosure.

226. MFR knew of, or recklessly ignored, the information available regarding the financial condition both America West and Radiant Oil. Similarly, MFR knew or recklessly ignored the negative financial condition of Galaxy, alleged above.

227. Defendants MFR and Padilla should have utilized a specialist to evaluate the life insurance policy valuation of the Funds because MFR and Padilla's they did not have expertise to perform and/or evaluate such valuations.

228. Accordingly, MFR should have but failed to utilize any professional skepticism in performing the audit of the Funds. Given MFR's departures from GAAS and its knowing or reckless disregard of red flags, MFR essentially performed no audit at all of the financial statements of Fund I as of and for the years ended December 31, 2009 and 2010, and essentially performed no audit at all of the financial statements of Fund II as of and for the year ended December 31, 2010.

229. For the reasons set forth above, the financial statements issued by Fund I as of and for the years ended December 31, 2009 and 2010, and Fund II for the year ended December 31, 2010 failed to comply with GAAP and GAAS because they overstated the Funds' assets, partners' capital and results of operations, specifically, the Funds' Statement of Assets and Liabilities and Schedule of Investments materially overstated the reported values of, among

others, common stock, transferable insurance policies, and promissory notes, thereby materially overstating the Funds' results of operations and partners' capital, and further, the financial statements failed to disclose related party transactions.

V. DERIVATIVE AND DEMAND FUTILITY ALLEGATIONS

230. Plaintiffs repeat and reallege the allegations above as if set forth fully in this section.

231. Plaintiffs bring this action derivatively in the right and for the benefit of the Funds to redress injuries suffered, as a direct and proximate result of the breaches of fiduciary duties and the aiding and abetting of breaches of fiduciary duties alleged herein.

232. Plaintiffs will fairly and adequately protect the interests of the Funds and their respective limited partners and has retained counsel competent and experienced in derivative litigation.

233. Mr. Rodney has been a limited partner of Fund I since 2007.

234. Mr. Debus has been a limited partner of Fund II since 2010.

235. Plaintiffs will continue to vigorously and conscientiously litigate this action and fulfill their responsibilities in representing the Funds' interests.

236. Because of the facts alleged in this complaint, under the laws of Delaware, a pre-suit demand on the Funds' general partner JTMC, which is managed by Jarkesy, to bring this action is excused because such a demand would have been a futile and useless act.

237. The Funds' general partner is JTMC, whose sole managing member is Defendant Jarkesy. For the reasons alleged herein, Jarkesy was not disinterested or independent. Because Jarkesy is not independent or disinterested, demand is futile and thus excused for all claims.

238. Jarkesy's conduct is such that board approval cannot meet the test of business judgment, and a substantial likelihood of his liability exists.

239. JTMC is controlled by Jarkesy and JTMC is beholden to him.

240. JTMC and Jarkesy face a substantial likelihood of personal liability arising from their breaches of fiduciary duties and waste of assets.

241. JTMC and Jarkesy exhibited a systematic failure to fulfill their fiduciary duties, which could not have been an exercise of good faith business judgment and amounted to bad faith, intentional or willful conduct, and gross negligence and/or recklessness.

242. Jarkesy faces substantial personal liability because of his failure to put in place or enforce appropriate controls necessary to assure that all actions were in the best interest of the Funds.

243. Additionally, Jarkesy and JTCM are and will continue to be, subjected to investigations and lawsuits for the actions alleged herein by the SEC.

244. For these reasons, JTCM and Jarkesy's ability to validly exercise their business judgment is impaired and they are incapable of reaching an independent decision as to whether to accept a demand by Plaintiffs to pursue claims on behalf of the Funds against themselves.

COUNT I

Breach of Fiduciary Duties
Against JTCM and Jarkesy

245. Plaintiffs repeat and reallege the allegations above as if set forth fully herein.

246. Defendants JTCM and Jarkesy were fiduciaries to the Funds and their respective limited partners.

247. Defendants JTCM and Jarkesy have violated their fiduciary duties of care, loyalty, and candor owed to the Funds and their respective limited partners by the acts and conduct alleged herein, and acted each intentionally, willfully or with at least gross negligence.

248. Due to the breaches of fiduciary duties by Defendants JTCM and Jarkesy, the Funds and their respective limited partners have been damaged. Plaintiffs seeks all damages available under the law.

COUNT II

Aiding and abetting Breach of Fiduciary Duties Against JTF, ATB, Belesis, MFR, Padilla and Doeren Mayhew, DM Texas, and South Padre

249. Plaintiffs repeat and reallege the allegations above as if set forth fully herein.

250. Plaintiff Debus alleges this claim against Defendants JTF, ATB, Belesis, MFR, Padilla and Doeren Mayhew, DM Texas, and South Padre. Plaintiff Rodney alleges this claim against Defendants MFR, Padilla, Doeren Mayhew, DM Texas, and South Padre.

251. As alleged above, Defendants JTCM and Jarkesy breached their fiduciary duties to the Funds. JTF, Belesis, ATB, Padilla and MFR colluded or aided and abetted the breaches of fiduciary duties alleged above, and were active and knowing participants in such breaches of fiduciary duties.

252. Such breaches of fiduciary duties could not and would not have occurred but for the conduct of Defendants JTF, Belesis, ATB, Padilla and MFR who, therefore, aided and abetted such breaches of fiduciary duties.

253. Belesis, and therefore JTF and ATB, was an active and knowing participant in JTCM's and Jarkesy's breaches of fiduciary duties. For example, Belesis as well as other JTF

employees and officers, monitored the performance of the Funds and received copies of account statements transmitted to limited partners.

254. As set forth above, MFR knew that its audits were on behalf of the limited partners of the Funds. MFR and Padilla ignored red flags and failed to exercise professional skepticism, among other violations of GAAS, in issuing clean audit opinions for Fund I for 2009 and 2010, and a clean audit opinion for Fund II for 2010. MFR's false audit opinions allowed Jarkesy, Belesis, JTF to reap unwarranted fees and concealed the truth about the Funds' financial condition.

255. Jarkesy's and JTCM's breaches of fiduciary duties to the Funds' partners could not and would not have occurred or continued but for the conduct of MFR and Padilla, and Belesis, JTF and ATB Holding.

256. Due to the unlawful acts of Defendants JTF, Belesis, ATB and MFR, the Funds have been damaged.

257. Defendants are jointly and severally liable. Plaintiffs seeks all damages available under the law.

COUNT III

Against the JTCM and Jarkesy for Waste

258. Plaintiffs repeat and reallege the allegations above as if set forth fully herein.

259. As alleged above, JTCM's and Jarkesy's excessive fees and payments to Jarkesy, Belesis and JTF constitute a waste of the Funds' assets.

260. The facts alleged above raise a reasonable doubt as to whether the fees and transactions were so one-sided as to be beyond the outer limit of JTCM and Jarkesy's discretion. Because of the JTCM and Jarkesy's waste of partnership assets, they are liable to the Funds.

Plaintiffs seeks all damages available under the law.

COUNT IV

Against MFR and Juan Padilla for Professional Negligence

261. Plaintiffs repeat and reallege the allegations above as if set forth fully herein.

262. Defendants MFR and Padillia owed the Funds, their clients, a common law duty to exercise reasonable care. Their duty to the Funds is as a result of the contract for professional services.

263. This duty of reasonable care requires the accountant to exercise the degree of care, skill, and competence that reasonable members of the profession would exercise under similar circumstances.

264. As set forth above, Defendants MFR and Padilla breached that duty by failing to comply with recognized industry standards in connection with the audits of Fund I for the years ended December 31, 2009, and 2010, the audit of Fund II for the year ended December 31, 2010.

265. Defendants MFR's and Padilla's breach was an actual cause of injury to the Funds, and in fact caused actual injury to the Funds. Plaintiffs seeks all damages available under the law.

COUNT V

Against all Defendants for Civil Conspiracy

266. Plaintiffs repeat and reallege the allegations above as if set forth fully herein.

267. Plaintiff Debus alleges this claim against all Defendants. Plaintiff Rodney alleges this claim against Defendants JTCM, Jarkesy, MFR, Padilla, Doeren Mayhew, DM Texas, and South Padre.

268. Defendants engaged in a civil conspiracy through their combination.

269. The object of the combination was to accomplish an unlawful purpose, or a lawful purpose by unlawful means.

270. Defendants had a meeting of the minds on the object and/or course of action.

271. One or more of the members committed an unlawful, overt act to further the object and/or course of action. Namely, Defendants Jarkesy and JTCM breached their fiduciary duty, and were aided and abetted by Defendants Belesis, JTCM, ATB Holding, MFR and Padilla.

272. As a proximate result of these wrongful acts, Plaintiffs suffered injury in an amount exceeding the jurisdictional minimum of this Court. In addition, Defendants committed the foregoing acts with the kind of willfulness, wantonness, and/or malice for which the law allows the imposition of exemplary damages, for which Plaintiffs sue.

273. Plaintiffs are entitled to their money damages, exemplary damages, pre and post-judgment interest, and costs.

274. Defendants are jointly and severally liable. Plaintiffs seeks all damages available under the law.

COUNT VI

Against MFR for Breach of Contract

275. Plaintiffs repeat and reallege the allegations above as if set forth fully herein.

276. MFR's engagement letters for Fund I for the years ended December 31, 2009 and 2010, and the engagement letter for Fund II for the year ended December 31, 2010 promised that "[t]he objective of our audit is the expression of an opinion about whether your financial statements are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit will be conducted in accordance with auditing

standards generally accepted in the United States of America.

277. As set forth above, MFR's audits were not in conformity with GAAP and GAAS.

278. MFR's breaches of contract caused damage to the Funds. Plaintiffs seeks all damages available under the law. Additionally, Plaintiffs are entitled to and seek recovery of their reasonable attorneys' fees and expenses expended in prosecuting this claim through trial and any appeals.

COUNT VII

Against Jarkesy and JTCM for Breach of Contract

279. Plaintiffs repeat and reallege the allegations above as if set forth fully herein.

280. The June 1, 2007 PPM promised limited partners in Fund I that the "total investment of the Partnership in any one company at any one time will not exceed 5% of the aggregate Capital Commitments.

281. In breach of the PPM, as of December 31, 2008, 33% of Fund I was invested in America West common stock, 9% was invested in Sahara Media Holdings, Inc. common stock and 9% was invested in Sahara Media Holdings, Inc. restricted common stock.

282. In breach of the PPM, as of December 31, 2009, 12% of Fund I was invested in Amber Alert Safety Centers, Inc. common stock, 25% in Amber Ready Inc. restricted common stock, 9% in America West common stock, and 10% was invested in America West restricted common stock.

283. In breach of the PPM, as of December 31, 2010, 10% of Fund I was invested in America West common stock, 16% was invested in America West restricted common stock, and 25% in Radiant Oil.

284. As set forth above, JTCM and Jarkesy promised to acquire life insurance

policies with a fact value of 117% or more of the aggregate capital commitments.

285. As set forth above, JTCM and Jarkesy failed to do so in breach of their promise.

286. Defendants' breaches of contract caused damage to Fund I. Plaintiffs seeks all damages available under the law. Additionally, Plaintiffs are entitled to and seek recovery of their reasonable attorneys' fees and expenses expended in prosecuting this claim through trial and any appeals.

JURY TRIAL DEMANDED

287. Plaintiffs have demanded a jury trial and have tendered the fee.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs respectfully request that Doeren Mayhew Texas, PLLC and South Padre Ventures 2, LLC be cited to appear and answer herein, and for the Court to award Plaintiffs the following relief:

A. Determining that this action is a proper derivative action maintainable under law and demand is excused;

B. Awarding against all Defendants and in favor of Funds the damages sustained by the Company as a result of the alleged breaches of fiduciary duties, aiding and abetting of such breaches, breaches of contract, professional negligence, and civil conspiracy;

C. Awarding the Funds restitution from Defendants and ordering disgorgement of all profits, benefits, and other compensation obtained by the Defendants;

D. Directing the Funds to take all necessary actions to reform and improve its governance and internal procedures, to comply with the Company's existing governance obligations and all applicable laws, including the removal of Jarkesy and JTCM as general partner, and to protect the Funds from a recurrence of the damaging events described herein;

E. Awarding to Plaintiffs the costs and disbursements of the action, including reasonable attorneys' fees, accountants' and experts' fees, costs, and expenses; and

F. Granting such other and further relief as the Court deems just and proper.

Dated: March 10, 2015

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CERTIFICATE OF SERVICE

The undersigned certifies that on this 10th day of March, 2017, a true and correct copy of the foregoing document was served on the following counsel of record as indicated:

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15255

In the Matter of	:
	:
JOHN THOMAS CAPITAL MANAGEMENT GROUP, LLC, d/b/a PATRIOT 28, LLC, and	:
	:
GEORGE R. JARKESY JR,	:
	:
Respondents.	:
	:

<u>OPENING AND RESPONSE BRIEF OF THE DIVISION OF ENFORCEMENT</u>

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PRELIMINARY STATEMENT

This matter involves misstatements and omissions of material fact by George R. Jarkesy, Jr. ("Jarkesy") and John Thomas Capital Management Group LLC, d/b/a Patriot28 LLC ("JTCM") (collectively, the "Respondents") in the offer and sale of shares of two hedge funds then known as the John Thomas Bridge and Opportunity Fund LP I ("Fund I") and the John Thomas Bridge and Opportunity Fund LP II ("Fund II") (collectively, the "Funds"). Jarkesy was the manager of the Funds and JTCM was the Funds' adviser. The Order Instituting Proceedings ("OIP") charged Jarkesy and JTCM with violations of the antifraud provisions of the federal securities laws, and with aiding and abetting and causing the Funds' violations of those provisions. The OIP also charged John Thomas Financial, Inc. ("JTF"), a broker-dealer that acted as the Funds' placement agent, and Anastasios "Tommy" Belesis ("Belesis"), the president and chief executive officer of JTF. JTF and Belesis settled the charges against them.

After a hearing, Administrative Law Judge Carol Fox Foelak ("the ALJ") found that the Respondents violated the antifraud provisions of the federal securities laws by making material misrepresentations and omissions concerning the Funds. In particular, the ALJ found that Fund I's private placement memorandum ("PPM") and marketing materials falsely represented that the Fund would not invest more than 5% of its capital in any one company and that the Fund would set aside sufficient cash to pay the premiums on certain life insurance policies that were part of the Fund's portfolio. Initial Decision ("ID") at 28. The ALJ also found that the Respondents made material misrepresentations and omissions concerning their relationship with JTF and Belesis, the value of the Funds, and the identity of the Funds' auditor. *Id.* at 29.

The ID ordered Respondents to cease and desist from violations of the antifraud provisions, to disgorge, jointly and severally, ill-gotten gains of $1,278,597 plus prejudgment interest, and to pay a third-tier penalty of $450,000. It also barred Jarkesy from the securities industry and from serving as an officer or director of a public or reporting company.

In their Petition for Review, Respondents raise a number of foundational challenges to these proceedings, including due process, equal protection, and other constitutional claims. Respondents also challenge certain of the ALJ's factual findings and legal conclusions. The Division of Enforcement ("Division") is challenging the ALJ's calculation of disgorgement, the amount of civil penalties ordered, and the failure to order an accounting. For the reasons set forth below, the Commission should affirm the factual and legal conclusions reached by the ALJ and reject the various due process, equal protection, and constitutional claims raised by the Respondents. However, the Commission should order full disgorgement, substantially higher penalties than were imposed by the ALJ, and an immediate accounting of the Funds' assets, sales and distributions.

FACTS

Respondents Made Numerous Material Misrepresentations to Investors

JTCM and Jarkesy managed two hedge funds. In 2007, Respondents launched Fund I and in 2009, they launched Fund II.[1] The investment objectives and strategies for the two funds were essentially identical: approximately half of each fund would be invested in corporate investments (with no more than 5% invested in a single company) and the other half would be invested in life settlement policies (totaling at least 117% of the investor capital), or be set aside to pay the premium on those policies. The life-settlement portion of each Fund was intended to hedge the more risky corporate investments. As Respondents represented, the corporate investments were intended to provide "return **on** capital" while the life settlements were intended

[1] For citations to the record, *see* Division's Proposed Findings of Fact and Conclusions of Law, filed Apr. 7, 2014.

to provide "return of capital." Respondents marketed the Funds as "two investments ... One Fund Hedged!" From 2007 through 2010, approximately 120 investors invested approximately $24 million in the Funds. In March 2012, Jarkesy wrote to investors that he was going to wrap up operations for Fund I that year. In 2013, Respondents formally dissolved the partnership. To this day, however, Respondents have not distributed the assets of the Funds to the investors, with the exception of the proceeds from one life settlement contract and some restricted stock. Respondents received approximately $1.3 million in management fees from the Funds. Additionally, Respondents received incentive fees of at least $123,000 from Fund II.

The evidence in the record and the facts adduced at the hearing clearly demonstrate that Respondents made numerous material misrepresentations to investors in connection with the offer and sale of shares in the Funds. Specifically, in the PPM and Limited Partnership Agreements, Respondents represented that: (1) half of all investor capital would be invested in small companies, including speculative start-ups, and the other half would be used to purchase life settlement policies (or would be set aside and segregated to pay premiums on the policies); (2) the life settlement policies would have a face value of at least 117% of the investor capital; (3) for the equity investments, the total investment in any one company at any one time would not exceed 5% of the aggregate capital commitments; (4) for the life settlement portfolio, Respondents would take steps to mitigate life expectancy risk, including purchasing a sufficient number of policies; (5) to further protect the life settlement portfolio, the policies would be transferred to the Master Trust; (6) the general partner, JTCM, would utilize good faith; (7) fair value would be used to value securities where no market quotation was readily available; (8) the Funds' financial statements would be prepared according to generally accepted accounting principles ("GAAP"); and (9) the management of the partnership would be vested exclusively in the General Partner. Each of these misrepresentations was material and important to investors making investment decisions. Because Respondents had "ultimate authority" over the PPM and its contents, they are liable for any misrepresentations contained therein. Many of these misrepresentations were repeated numerous times in other documents that were attributable to Respondents, including marketing materials, power point presentations, periodic investor updates (including a podcast following the release of the 2008 audited financial statements), monthly account statements, and in the Funds' audited financial statements.

Respondents' marketing materials and investor updates contained additional misrepresentations, including that: (1) KPMG was the auditor for the Funds; (2) Deutsche Bank was the prime broker for the Funds; (3) insurance policies would be purchased from AA rated insurance companies; (4) Fund I had purchased fourteen life settlement policies from fourteen separate insurance companies; (5) the bridge loans would be "collateralized;" and (6) valuation of the Funds' assets would be conservative. Respondents' website made the further misrepresentation that JTF did not manage, direct, or make any decisions for the Funds. These misrepresentations, which also are attributable to Respondents, were material and important to investors making investment decisions.

In addition to the misrepresentations, Respondents fraudulently valued many of the positions in the portfolio including: (1) the life insurance policies, which Respondents valued using a 12% discount rate instead of the 15% discount rate implied by the purchase price and that the valuation consultants believed was the most appropriate; (2) the restricted stock, which Respondents valued at the same price as free-trading stock; (3) the notes of America West Resources ("America West") and Galaxy Media & Marketing Corp. ("Galaxy"), which

Respondents valued at par notwithstanding that the notes were in default; (4) the shares of Radiant Oil & Gas, Inc. ("Radiant") and America West, which Respondents valued based upon promotional activities they paid for with money from the Funds; (5) the Radiant warrants, which Respondents valued arbitrarily and without any relationship to the stock price; and (6) the shares of portfolio companies like Galaxy and America West, which Respondents overvalued given the poor financial condition of those companies. These valuations, which Respondents knew lacked any reasonable basis, were fraudulent.

STANDARD OF REVIEW

The Commission's Rule of Practice 411(a) provides that in reviewing initial decisions of administrative hearing officers, the Commission "may make any findings or conclusions that in its judgment are proper and on the basis of the record." 17 C.F.R. § 201.411(a). Pursuant to this rule, the Commission considers an appeal of an administrative law judge's initial decision on a *de novo* basis. *See* 5 U.S.C. § 557(b) (Administrative Procedures Act ("APA") provision granting agency reviewing initial decision "all the powers which it would have in making the initial decision except as it may limit the issues on notice or by rule"). *See also Mr. Sprout, Inc. v. United States*, 8 F.3d 118, 123 (2d Cir. 1993) (characterizing § 557(b) as allowing for *de novo* review of initial decision by Interstate Commerce Commission); *Gross v. SEC*, 418 F.2d 103, 105, 107-108 (2d Cir. 1969) (applying § 557(b) and *de novo* standard to Commission appellate decision); *Commercial Capital Corp. v. SEC*, 360 F.2d 856, 857-58 (7th Cir. 1966) (applying provisions of APA to activities of Commission).

ARGUMENT

I.e Respondents' Due Process, Equal Protection, and Constitutional Claims Lack Merite

A.e The Commission Has Not Prejudged Claims Against Respondents and There e Have Been No Improper Ex-Parte Communications Between the Divisione and the Commissione

Respondents contend that these proceedings deprive them of their due process rights and are void because the Commission allegedly has prejudged the case against them by issuing an Order Making Findings, Imposing Remedial Sanctions and a Cease-and-Desist Order on December 5, 2013 against two settling respondents, Belesis and JTF (the "December 5 Order"). *See* Respondents' Opening Brief ("Resp. Br.") at 4-8. Because the December 5 Ordere contains factual and legal findings that Respondents contest, they argue that the Commission is biased and cannot fairly adjudge the case against them, notwithstanding the fact that the December 5 Order specifically states that the findings "are not binding on any other person or entity in this or any other proceeding." Respondents also contend that the Commission engaged in impermissible *ex parte* communications with the Division in connection with that settlement. Resp. Br. at 21-28. Respondents argue that these supposed *ex parte* communications violate their due process rights and the APA. Based on these purported violations, Respondents state that that the case against them is void and must be dismissed.[2]e

The Commission repeatedly has found Respondents' arguments to be meritless, including in this very action where the Commission denied Respondents' Petition for Interlocutory Review on these same issues. (Jan. 28, 2014 Order Den. Pet. for Interlocutory Review). For example, in

[2] Respondents separately filed a motion asking the Commission to recuse itself from hearing this matter. Because the arguments in the Respondents' brief and motion for recusal are the same, the Division addresses them both in this single brief.

Edward Sinclair, 1971 SEC LEXIS 898 (1971), the respondent, who was an order clerk for Filor, Bullard & Smith, argued that any Commissioner who participated in the decision on consent to suspend Filor for failing to supervise should be disqualified from hearing the case. The Commission rejected this argument stating that there was "no merit in the motion." The order against Filor was based on a stipulated record and, like the December 5 Order, expressly stated that it was not binding on the other respondents. The Commission stated that its present decision regarding the respondent was based solely on the record before it "and is no way influenced by our findings as to Filor based on the order of the settlement."

On appeal, the Second Circuit agreed that Commissioner Smith was not biased and did not need to disqualify himself:

> We find no merit in the argument that Commissioner Smith had prejudged Sinclair's case by participating in the Commission's decision to accept a Filor settlement offer setting forth certain stipulated facts. The facts were stipulated by the parties solely for the particular settlement, just as is the practice in negotiation of consent decrees. The decision stated that it was not binding on the other respondents. Furthermore, each of the two proceedings met the standards of due process with each respondent ... being represented by competent counsel. The Commission's findings with respect to Sinclair were based upon presentation of evidence before a Hearing Examiner, findings independently made by him on the basis of the proof, and independent review by the Commission after oral argument and submission of briefs. In such a context Commissioner Smith was not called upon to disqualify himself from participation in Sinclair's case.

Sinclair v. SEC, 444 F.2d 399, 401-02 (2d Cir. 1971). More recently, in *Stuart-James Co., Inc.*, 1991 SEC LEXIS 168 (Jan. 23, 1991), the Commission held that its settlement with one respondent did not require that the Commissioners who accepted that settlement be disqualified or the administrative proceeding be dismissed. The Commission stated, "[t]aken at face value, the respondents' arguments suggest that it is virtually impossible for the Commission properly to entertain individual settlements in proceedings involving multiple respondents." *Stuart-James*, 1991 SEC LEXIS 168, at *3. Rejecting this argument, the Commission found that consistent with due process, it could "authorize investigations of suspected securities law violations, institute enforcement proceedings to determine whether the suspected violations occurred, and later make findings of fact and conclusions of law on the basis of the record that is compiled. We may also consider offers of settlement during the course of those proceedings." *Id.* at *5. The Commission further held that it could have communications with the Division about the settlement stating that "[t]o exclude our staff from presenting relevant facts concerning a negotiated settlement would simply lead to wrong decisions about which settlement offers merited acceptance. Such a result is not in the public interest and is not required by statute or rules." *Id.* at *12.

Finally, while the Commission recognized that "non-settling respondents might wish to appear before us to dispute information presented by the staff, or to argue additional facts which they believe would influence our assessment of the public interest," it held that there was no such requirement under the APA and "[c]ontrol over [the Division's] access to the Commission cannot be turned over to private parties." *Id.* at *14-19. Consequently, the Commission held that so long as the Division is not participating or advising in a decision by the Commission as to the non-settling respondents, "there is no compelling reason the communications [between the Division and the Commission] as to a proposed settlement by one respondent in a multi-party proceeding may not take place *ex parte*." *Id.* at *20. *See also C. James Padgett*, 1997 SEC LEXIS 634, *59 (Mar. 20, 1997) (rejecting argument that by accepting settlement of one respondent it had prejudged other respondents' liability and had engaged in improper *ex parte* communications with Division, and stating while "[t]he APA and Commission rules prohibit *ex parte* communications relating to the decisional process ... circumscribed Division communications with the Commission in connection with a proffered settlement by one respondent in a multi-party proceeding are not part of the decisional process regarding other parties"); *Jean-Paul Bolduc*, 2001 SEC LEXIS 2765, *5 (Jan. 25, 2001) (finding no bias by virtue of settlement with another party, but also "[a]n administrative body such as the Commission may not be disqualified from performing its adjudicatory functions based on allegations of bias, prejudice, or prejudgment on the part of the Commission or its members.") (*citing FTC v. Cement Institute*, 333 U.S. 683 (1948)); *Atlantic Equities Co.*, 1967 SEC LEXIS 531 *28-29 (July 11, 1967) ("in our opinion, the claim of 'prejudgment' [based on an earlier settlement] is without substance"), *aff'd sub nom., Hanson v. SEC*, 396 F.2d 694 (D.C. Cir.); *Steadman Security Corp.*, 1977 SEC LEXIS 1388, *56 n.82 (June 29, 1977) (denying as "meritless" motion to dismiss on grounds of prejudgment, stating that APA permits the Commission to consider settlement in its administrative capacity "and thereafter render a decision with respect to it in our quasi-judicial capacity").

Because the Commission is allowed to consider a settlement by one respondent in an administrative action without having to disqualify itself with respect to any other respondent, it follows that any communications between the Division and the Commission in connection with that settlement are also not improper (and, in fact, are necessary), do not violate due process of law, and do not require the Commission to disqualify itself or to dismiss the action. The Commission should follow its own precedent and deny Respondents' petition, which is based on the same arguments and the same facts as the decisions discussed above.[3] In denyinge Respondents' Petition for Interlocutory Review, the Commission admonished Respondents for their failure to address this unbroken line of Commission decisions, stating: "[a]lthough JTCM

[3] Respondents argue that the findings concerning their own actions in the December 5 Order were "gratuitous and totally unnecessary." This argument ignores the fact that the settling respondents were charged not as primary violators, but as aiders and abettors. Because such a charge requires an underlying violation of the securities laws, the December 5 Order had to contain findings of underlying violations. It is clear from the order, however, that such findings were not binding on the Respondents.

and Jarkesy are 'entitled to make a good faith argument for a change of law', they are 'obligated to acknowledge that they are doing just that and deal candidly with the obvious authority that is contrary to [their] position.'" Order of January 28, 2014 at 4. Respondents still do not deal candidly with the Commission's precedent on this very issue.

Recognizing the weakness of their argument, Respondents claim that the language in the Order with JTF and Belesis stating that the findings are not binding on any other person or entity does not apply to the Commission itself which, they assert, is bound by its prior findings. This is incorrect, as the Commission specifically stated in denying the Respondents' Petition for Interlocutory Review in this matter:

> In particular, the Commission has determined previously that no prejudgment of a non-settling respondent's case occurs especially when—as took place here—the order accepting an offer of settlement "expressly state[s] that it was not binding on other [non-settling] respondents." Any decision that the Commission makes as to JTCM and Jarkesy will be "based solely on the record" adduced before the law judge and will "in no way [be] influenced by our findings as to [JTF and Belesis] based on [their] offer of settlement."

Order Den. Pet. for Interlocutory Review at 4 (footnotes omitted) (*citing Sinclair*, 1971 WL 120487, at *4 (Mar. 24, 1971)). It is clear that the Commission does not consider itself bound by the prior findings in the Order approving settlements with other Respondents and is free to deviate from those findings if they do not accord with the evidence in the record adduced before the ALJ.

Respondents' attempt to distinguish their situation from *Stuart-James* and its progeny is entirely unavailing. *See* Resp. Br. at 24-27. Respondents merely restate, without providing any evidence in support, that the Commission has prejudged the case against them by making findings of fact with respect to the settling respondents, and state that "the Commission, by virtue of its improper *ex parte* contact with the Division, issued findings of fact pertaining to the non-settling Respondents." Resp. Br. at 26. Respondents simply ignore the unambiguous statement in the prior settlement that the factual findings are not binding on any other party. The Commission never issued any findings of fact pertaining to these Respondents.

Finally, while Respondents argue that the Commission violates the APA by considering settlements with respect to certain respondents if others are litigating the matter, the opposite is true. As the ALJ noted in the ID, a prohibition on considering settlements would likely run afoul of the APA:

> It is well established that the Commission's combining administrative and adjudicative functions is consistent with due process, including when the Commission considers settlement as to one or more respondents, but review an initial decision as to another respondent based on similar facts. A policy prohibiting settlements during the pendency of a multi-party proceeding would be contrary to the APA, which requires an agency to give all interested parties the opportunity for the submission and consideration of offers of settlement, when time, the nature of the proceeding, and the public interest permit.

ID at 3 (internal citations omitted).

B. The Division Properly Produced All Required Documents and Complied with its Obligations Under *Brady* v. Maryland

Respondents assert that their due process rights were violated because the Division allegedly produced documents in a "document dump" and withheld supposedly exculpatory material contrary to the doctrine of *Brady v. Maryland.* Resp. Br. at 28-32. This claim is also meritless and was soundly rejected by the Commission which previously held in this case that Respondent "failed to grapple with [Supreme Court] authority [and] [t]heir contrary reliance on the unpublished district court decision in United States v. Salyer is misplaced." (Dec. 6, 2013 Order Den. Pet. for Interlocutory Review at 9-10).

The Division's discovery obligations are described in Rule 230 of the Commission's Rules of Practice. Pursuant to Rule 230(a)(1), the Division "shall make available for inspection and copying ... documents obtained by the Division prior to the institution of proceedings, in connection with the investigation leading to the Division's recommendation to institute proceedings." Pursuant to Rule 230(a)(2), the Division may withhold documents that are obtained prior to the institution of proceedings that: (1) are privileged; (2) are internal memoranda, notes, or other attorney work product so long as those documents are not going to be offered into evidence; (3) identify confidential sources; and (4) the hearing officer grants leave to withhold for good cause shown. Rule of Practice 230(b)(1). The Division, however, may not withhold documents that contain material exculpatory evidence under *Brady v. Maryland*, 373 U.S. 83, 87 (1963). Rule of Practice 230(b)(2).

The Commission has described the Division's *Brady* obligations as follows:

> The Rules of Practice do not "authorize respondents to engage in 'fishing expeditions' through confidential Government materials in hopes of discovering something helpful to their defense. Unless defense counsel becomes aware that exculpatory evidence has been withheld and brings it to the judge's attention, the government's decision as to whether or not to disclose information is final. Mere speculation that government documents may contain Brady material is not enough to require the judge to make an in camera review. In order to justify such a review, a respondent must first establish a basis for claiming that the documents contain material exculpatory evidence. A 'plausible showing' must be made that the documents in question contain information that is both favorable and material to the respondent's defense."

Orlando Jett, 1996 SEC LEXIS 1683, *1-2 (June 17, 1996) (emphasis added); *see also OptionsXpress, Inc.*, 2013 SEC LEXIS 3235 (Oct. 16, 2013).

The Division complied with all disclosure requirements under the Commission's Rules of Practice. In fact, the Division exceeded its disclosure requirements, providing its entire investigation file (excluding privileged materials) to Respondents in a searchable Concordance database at no charge. Prior to producing the database, the Division produced to Respondents the investigative testimony taken prior to the commencement of this action (to the extent the Division had the transcripts) as well as all of the exhibits to that testimony, which taken together, comprised its "hot documents" file. The Division repeatedly offered to make the entire investigative file (exclusive of privileged documents) available to Respondents for inspection and copying at the Commission's New York Regional Office at Respondents' convenience. Respondents never accepted the Division's offer.

The Division also provided to Respondents a "withheld document list" and a declaration that, read together, named the potential witnesses the Division interviewed where there was no transcript (both before and after the filing of this action), and summarized all of the potentially exculpatory material provided by these witnesses. The declaration further provides that the other withheld documents (internal Division emails, memoranda, and spreadsheets) do not contain material exculpatory statements under *Brady*.

Respondents further contend that because of the way the documents were produced to them, they did not have time to adequately review them. However, the Division produced its files to Respondents in the same way that the Division keeps the documents, that is, in an electronically searchable Concordance database format. The Commission previously has rejected Respondents' arguments, noting that "JTCM and Jarkesy's estimates for how long it would take to conduct a page-by-page review of the materials are irrelevant; they can use Concordance's search capabilities to home in on the documents that they need to prepare for the hearing." *John Thomas Capital Mgmt. Group LLC*, 2013 SEC LEXIS 3860, *22, n.37 (Order Den. Pet. for Interlocutory Review, Dec. 6, 2013). Most important perhaps, Respondents fail to acknowledge that the majority of the documents produced to them were the Respondents' *own* documents, that is, documents Respondents had produced to the Division during the investigation in response to subpoenas and document requests.

1. The Division Complied With Its *Brady* Obligations

The Division has not kept any potentially exculpatory materials from the Respondents. It produced its entire investigative file except for privileged materials (consisting of interview notes) and, even with respect to the privileged material, it summarized all potentially exculpatory material contained in those notes.

It has long been held that an "open file" policy satisfies the requirements of *Brady*. In *Strickler v. Greene*, 527 U.S. 263, 283 n.23 (1999), for example, the Supreme Court stated "we certainly do not criticize the prosecution's use of the open file policy. We recognize that this practice may increase the efficiency and the fairness of the criminal process." In *United States v. Warshak*, 631 F.3d 266, 297 (6th Cir. 2010), the Sixth Circuit Court of Appeals rejected the defendant's argument that the government failed to comply with its *Brady* obligations when it handed over "millions of pages of evidence and forc[ed] the defense to find any exculpatory information contained therein." The court held that there was no evidence that the government acted in bad faith, larding its production with entirely irrelevant documents or concealing exculpatory evidence in the information turned over. Consequently, the court rejected the argument that the government was obliged to sift through all of the evidence in an attempt to locate anything favorable to the defense, stating that such an argument "comes up empty." In *United States v. Rubin/Chambers, Dunhill Ins. Servs.*, 825 F. Supp.2d 451, 454-55 (S.D.N.Y. 2011), the court held that "it is apparent that prosecutors may satisfy their Brady obligations through 'open file' policies or disclosure of exculpatory or impeachment material within large production of documents of files." And "even when the material disclosed is voluminous," in the absence of prosecutorial misconduct [bad faith or deliberate attempts to knowingly hide *Brady* material] the prosecutor's use of "open file disclosures ...does not run afoul of Brady."

Similarly, in *United States v. Ohle*, 2011 U.S. Dist. LEXIS 12581, *7-11 (S.D.N.Y. Feb. 7, 2011), the court rejected defendants' argument that the prosecutors should be required to identify specific *Brady* documents within the files produced by the government -- even though the government in that case had produced nine separate searchable Concordance databases to the defendants, which contained several gigabytes of data "including millions of separate files extending to several million pages in length." The court held that "as a general rule, the Government is under no duty to direct a defendant to exculpatory evidence within a larger mass of disclosed evidence." *Ohle*, 2011 U.S. Dist. LEXIS 12581 at *11 (internal citations omitted). Moreover, the court noted that while there were many documents, the government had produced an electronically searchable database, to which both parties had equal access, and therefore the defendants "were just as likely to uncover the purportedly exculpatory evidence as was the Government." *Id.* at *10. *See also United States v. AU Optronics Corp.*, 2011 U.S. Dist LEXIS 148037 (N.D. Cal. Dec. 23, 2011) (denying motion seeking order requiring the government to review 37 million pages of documents produced to identify potentially exculpatory material under *Brady*).

2. The Division's Interview Notes are Privileged

It is beyond contention that witness interview notes are privileged work product. *See, e.g., United States v. Gupta*, 848 F.Supp.2d 491, 496 (S.D.N.Y., Mar. 26, 2012) (SEC's witness interview notes are protected work product requiring a showing of "substantial need" by defendant); *SEC. v. Nadel*, 2013 U.S. Dist. LEXIS 36251, *1-9 (E.D.N.Y. Mar. 15, 2013) (SEC interview notes constitute opinion/core work product and are subject to heightened protection); *SEC v. NIR Group, LLC*, 283 F.R.D. 127, 135 (E.D.N.Y. Aug. 17, 2012) (SEC notes and memoranda relating to witness and investor interviews are "highly protected work product of which production may not be demanded"); *SEC. v. Strauss*, 2009 U.S. Dist. LEXIS 101227, *12-15 (S.D.N.Y. Oct. 28, 2009) (application to compel production of SEC interview notes and memoranda denied, since SEC interview notes and memoranda prepared in anticipation of litigation fit within protection of work-product doctrine). The witness interview notes at issue relate to interviews conducted by Division attorneys in connection with the investigation of Respondents, and were conducted in anticipation of this litigation. Although some of the interviews predated the formal initiation of this litigation, they "were conducted in order to provide the Commission with information so that it could make the determination whether to proceed with litigation," and thus, fall "squarely within the protections of the work-product doctrine." *SEC v. Cavanagh*, 1998 U.S. Dist. LEXIS 3713 at *5-6 (S.D.N.Y. Mar. 23, 1998). Because notes of attorneys' investigative interviews inherently reflect their mental impressions, opinions, theories and conclusions, such notes have long been entitled to the strictest level of work product protection. *See, e.g., Upjohn Co. v. United States*, 449 U.S. 383, 398-401 (1981) (disclosure of attorney interview notes is disfavored, and justified either rarely or "never"), *SEC. v. Stanard*, 2007 U.S. Dist. LEXIS 46432, *4 (S.D.N.Y. June 26, 2007) (analysis of case "in anticipation of litigation" is work product, and receives heightened protection under Rule 26(b)(3)); *SEC v. Treadway*, 229 F.R.D. 454, 455-56 (S.D.N.Y. July 26, 2005) (notes protected by work product privilege because they represent attorney work product that at least in part, reflects thought process of counsel); *SEC v. Downe*, 1994 U.S. Dist. LEXIS 708, *6-8 (S.D.N.Y. Jan. 27, 1994) (attorney work product based on oral statements of witnesses is likely to reveal attorney's mental processes).

While the Division did not turn over the witness notes to Respondents (except for one inadvertent disclosure), the Division provided a declaration describing all of the potentially exculpatory statements contained within such notes, which has been held to be sufficient under Rule 230. *See Bandimere* 2013 SEC LEXIS 746, *8 (Mar. 12, 2013) (Order of ALJ Elliot denying respondent's request for production of interview notes when Division provided essential facts and substance of material exculpatory evidence in affidavit); *Dearlove*, 2006 SEC LEXIS 1476, *5 (Order of ALJ Kelley, Jan. 19, 2006) (declaration satisfies *Brady* obligations). Respondents speculate that the interview notes may contain other information that was not provided to them.[4] Mere speculation is insufficient to require the production of such notes even for an *in camera* review. *Jett*, 1996 SEC LEXIS 1683 at *2 ("Mere speculation that government documents may contain Brady material is not enough to require the judge to make an in camera review"); *OptionsXpress*, 2013 SEC LEXIS 3235 at *15 (respondents must make plausible showing that documents contain information both favorable and material to their defense). In fact, the Commission reviewed the interview notes for investor Steven Benkovsky that had inadvertently been produced and concluded that those notes did not contain any additional undisclosed exculpatory material. Since these notes did not contain any undisclosed *Brady* material, the Commission held that Respondents argument that the other notes contained undisclosed material was mere speculation. Dec. 6, 2013 Order at 8. Likewise, during the course of the hearing, at Respondents' request the ALJ reviewed *in camera* the notes taken of investor Robert Fulhardt and concluded that "there is nothing there." Tr. 1414-15.

As described above, the Division has produced its entire investigative file to Respondents with the exception of privileged material. With respect to the privileged material, the Division provided a declaration to Respondents describing the potentially exculpatory materials contained

[4] *See, e.g.*, Resp. Br. at 31 ("Respondents ... were forced to the hearing without the *Brady* material that was almost certainly in the Division's possession.")

in the interview notes and stating that the other privileged material does not contain material exculpatory statements.

C. The Commission's Exercise of Discretion in Forum Selection Does Not Violate the Separation of Powers Doctrine

Respondents next contend that the "transfer of coextensive administrative enforcement authority to the Commission" pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 11-203, H.R. 4173) ("Dodd-Frank") "constitutes a delegation of legislative authority" that "tramples the doctrine of separation of powers." Resp. Br. at 8. Respondents refer to the "delegated power of the Commission to institute administrative enforcement actions" and claim that "the delegation to exercise this new administrative enforcement authority was legislative" in violation of the separation of powers doctrine. Resp. Br. at 9. This contention is nonsensical, and the cases cited by Respondents provide no support for it.

First, the relevant provisions of Dodd-Frank do not constitute a delegation of legislative authority. The relevant provisions of Dodd-Frank at issue did not transfer administrative authority to the Commission, nor did it create a new administrative authority; rather, with the enactment of Dodd-Frank, Congress provided the statutory authority for the Commission to obtain civil penalties in cease-and-desist proceedings brought to enforce the federal securities laws. When the Commission brings an action to enforce the federal securities laws, whether in federal district court or in administrative proceeding pursuant to Dodd-Frank, it is not acting in a *legislative* capacity. Rather, it is acting in an *executive* capacity, to enforce the laws that

Congress has enacted in accordance with the statutory mechanisms that Congress has explicitly provided.[5e]

Second, the fact that Congress enacted a statutory scheme that allows the Commission to choose the forum in which to bring an enforcement action does not constitute a delegation of legislative authority. The choice of forum is not a legislative act, but part of the discretionary decision making authority the Commission has in carrying out its statutory mandate to execute the law. It is no different than the decision making authority that the Commission exercises every time it decides whether or not to bring an enforcement action at all,[6] regardless of thee forum, or when it decides which of many potential statutory violations it chooses to bring.[7] Suche decision making is not legislative in character, but part of the executive function.

Respondents contend that "Government actions that 'have "the purpose and effect of altering the legal rights, duties, and relations of persons ... outside the Legislative branch,"' constitute legislative action." Resp. Br. at 8-10 (*quoting Metro. Wash. Airports Auth. V. Citizens for Abatement of Aircraft Noise, Inc.*, 501 U.S. 252, 276 (1991)). Respondents further contend that "[t]he decision-making surrounding agency adjudications 'alter [] the legal rights, duties, and relations of persons ... outside the legislative branch,' and involve 'determinations of policy.'" Resp. Br. at 9 (*quoting INS v. Chadha*, 462 U.S. 919, 952, 954 (1983)). Both of these contentions are wide of the mark, and the cases cited provide no support for Respondents'

[5] *Cf., Morrison v. Olson*, 487 U.S. 654, 706 (1988) (Scalia J. dissenting) ("Governmental investigatione and prosecution of crimes is a quintessentially executive function.")

[6] *See, e.g.,* Heckler v. Chaney, 470 U.S. 821, 832 (1985) ("[W]e recognize that an agency's refusal to institute proceedings shares to some extent the characteristics of the decision of a prosecutor in the Executive Branch not to indict – a decision which has long been regarded as the special province of the Executive Branch, inasmuch as it is the Executive who is charged by the Constitution to 'take care that the Laws be faithfully executed.'") (internal citation omitted)

[7] This is true even in the criminal context. The Supreme Court "has long recognized that when an act violates more than one criminal statute, the government may prosecute under either so long as it does not discriminate against any class of defendants." *U.S. v. Batchelder*, 442 U.S. 114, 123-24 (1979).

position. If every government action that has the effect of altering the legal rights, duties, and relations of persons constitutes *legislative* action, then every *executive* action would be turned into an instance of *legislative* activity. Likewise, treating the decision-making surrounding agency adjudication as a broad *policy* determination, would turn every instance of law enforcement – every prosecution, enforcement action, or statutory implementation, all classic examples of *executive* action – into quasi-legislative acts. It is Respondents' conflation, and frankly confusion, over what constitutes an executive action and what constitutes legislative action that does violence to the principle of separation of powers. As the Supreme Court held almost one hundred years ago, "[l]egislative power, as distinguished from executive power is the authority to make laws, but not to enforce them or appoint the agents charged with the duty of such enforcement. The latter are executive functions." *Springer v. Gov't of the Philippine Islands*, 227 U.S. 189, 202 (1928).

The cases cited by Respondents provide no support for their arguments. The underlying question in those cases was whether a part of *Congress* was engaging in actions that were legislative in nature – that is, whether some part of Congress was exercising legislative power – such that they could only lawfully be undertaken pursuant to the constitutional requirements for legislative enactment, namely passage by a majority of both houses and presentment to the President for signature or veto.

INS v. Chadha concerned the constitutionality of a statute that provided that either house of Congress could, by resolution, invalidate a decision by the Attorney General – an executive branch officer acting pursuant to authority delegated by Congress – to allow a deportable individual to remain in the United States. The court held that this legislative veto violated the separation of powers because Congressional action overturning an executive order on deportation was necessarily legislative in character, and could lawfully be accomplished only through normal legislative processes, namely passage of a new bill by both houses of Congress and presentment to the President. *See INS v. Chadha*, 462 U.S. 919, 952-55 (1983). Nothing like that is at issue here, where Congress has empowered an executive agency to enforce the law. The separation of powers would only be implicated if Congress had somehow reserved to itself the power to overturn the Commission's actions.

Metropolitan Washington Airports Auth. v. Citizens for Abatement of Aircraft Noise, Inc., similarly is inapposite. That case involved the transfer of two airports owned by the federal government to a new regional airport authority created pursuant to laws enacted by the District of Columbia and the State of Virginia. Congress authorized the transfer conditioned on the District and the State creating a review board (the Board) composed of nine members of Congress who would have veto power over the Board's decisions. The court held that this arrangement violated the separation of powers on one of two grounds: if the Board was deemed to be exercising legislative power, then its actions would violate the requirement that legislation requires action by both houses of Congress and presentment to the President, and not a small subset of Congress; if the Board was deemed to be exercising executive power, then it would constitute an unconstitutional delegation by Congress of executive authority to its own agents. *See Metropolitan Washington Airports Auth. v. Citizens for Abatement of Aircraft Noise, Inc.*, 501 U.S. 252, 274-77 (1991). Once again, nothing of the sort is at issue here. With the passage of Dodd-Frank, Congress provided the Commission – the Executive – new powers to enforce the laws; Congress did not thereby delegate to a subset of itself the power to legislate, nor did it delegate the executive power to its own agents.

To argue that Congress unlawfully delegated legislative authority in violation of the separation of powers doctrine when it authorized new administrative remedies to enforce the laws Congress passed, turns logic on its head. It is Congress that could not institute enforcement proceedings without violating the separation of powers doctrine because it would be acting in both a legislative and executive capacity.[8e]

Finally, to whatever extent the choice of forum can be seen as involving some policy determination, the Supreme Court has held that Congress has considerable leeway in setting the boundaries of executive judgment: "In short, we have 'almost never felt qualified to second-guess Congress regarding the permissible degree of policy judgment that can be left to those executing or applying the law.'" *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 464-75 (2001) (internal citation omitted). While it is true that any delegation of quasi-legislative authority must be limited by an "intelligible principle," the court has found that principle to be met in a host of circumstances where the degree of agency discretion is far greater than what is at issue here. Indeed, the court has upheld a broad degree of discretion even in cases that involve an agency's rule making authority.[9] *See, e.g., Entergy Corp. v. Riverkeeper, Inc.*, 566 U.S. 208, 218-23 (upholding Congressional delegation of discretionary authority to EPA to decide whethere it should consider costs in making certain rules); *Whitman*, 531 U.S. at 472-76 (approving delegation to EPA to set national standards for air quality). The case at hand here – which involves nothing more than the forum the Commission chooses when executing the laws enacted

[8] *See, e.g., Buckley v. Valeo*, 424 U.S. 1, 138-39 (1976) (finding that FCC enforcement power cannot be regarded as an aid of the legislative functions of Congress, and concluding that remedy for breaches of law resides in the executive).

[9] *See, e.g., Department of Transportation v. Assn. of American Railroads*, 575 U.S. ___ (2015), 2015 U.S. LEXIS 1763, *66 (Mar. 9, 2015) ("For whatever reason, the intelligible principle test now requires nothing more than a minimal degree of specificity in the instruction Congress gives to the Executive when it authorizes the executive to make rules having the force and effect of law.") (Thomas J., concurring).

by Congress – presents none of the concerns that exist when an agency is engaged in rule making.

Respondents further claim that when Congress authorizes administrative procedures to resolve certain perceived problems, those procedures must be exclusive, and that the "boundaries required by [that] exclusivity" were breached by giving the Commission the power to decide in what forum to bring an enforcement action.[10]

However, the relevant section of the case Respondents cite in support of this proposition (*Free Enterprise Fund v. PCAOB*) has nothing to do with the question at issue here. The question the court was facing in the cited section of *Free Enterprise Fund* was whether a federal district court had jurisdiction to hear a constitutional challenge to the validity of the Public Company Accounting Oversight Board, or whether such a challenge had to first proceed through the administrative process at the conclusion of which it could be reviewed by an appellate court as provided by statute. The court noted that when Congress provides a mechanism for agency review by an aggrieved party, that mechanism is generally considered exclusive, but not in cases where it would effectively close off all avenues of judicial review. *See Free Enterprise Fund*, 561 U.S. at 489. That holding, concerning the jurisdiction of a federal district court to hear a facial challenge to the very existence of an administrative body, has nothing to do with the question whether Congress can provide an agency with the authority to bring an enforcement action either as an administrative proceeding or a federal district court action. Respondents

[10] *See* Resp. Br. at 10: "The Court has repeatedly stressed that 'when Congress creates procedures "designed to permit agency expertise to be brought to bear on particular problems," those procedures "are to be exclusive."' *Free Ent. Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 489 (2010); *Whitney Nat'l Bank of Jefferson Parish v. Bank of New Orleans & Trust Co.*, 379 U.S. 411, 419-20 (1965). The boundaries required by the exclusivity of legislatively-created administrative procedures were uniquely lifted by Dodd-Frank, however, leaving it to the Commission to decide for itself which procedures are 'to be brought to bear' in the enforcement of securities statutes."

provide no support for the proposition that when Congress authorizes administrative resolution of certain agency actions such procedures must be exclusive.

D. Selection of the Administrative Proceeding as a Forum does not Violate Respondents' Equal Protection Rights

Respondents next contend that the decision to proceed in an administrative forum deprived them of their right to equal protection for two reasons: first, because it deprived them of their Seventh Amendment right to a jury trial in a discriminatory way that cannot survive strict scrutiny analysis; second, that it contravenes their equal protection rights pursuant to the "class of one" doctrine. Resp. Br. at 12. Both claims lack merit.

1. Use of the Administrative Forum Did Not Unfairly Deprive Respondents of their Seventh Amendment Jury Trial Rights

Respondents claim that the choice of an administrative forum violates their fundamental right to a jury trial and therefore denies them equal protection under the law. This claim flies in the face of controlling Supreme Court precedent. While Respondents go on at length about the importance of the jury trial in American history and how the right is so fundamental that any deviation must be subjected to strict scrutiny analysis, they completely fail to address how the Supreme Court's holding in *Atlas Roofing Co. v. Occupational Safety & Health Review Commission,* 430 U.S. 442 (1977), affects their fundamental rights analysis. *See* Resp. Br. at 13-17. In *Atlas Roofing,* the Supreme Court held that the use of administrative proceedings that lack juries *does not* violate the Seventh Amendment: "[T]he Seventh Amendment does not prohibit Congress from assigning the fact finding function and initial adjudication to an administrative forum with which the jury would be incompatible." 430 U.S. at 450. Following *Atlas Roofing,* the Commission consistently has rejected claims that administrative proceedings violate the Seventh Amendment right to a jury trial. *See, e.g., Harding Advisory LLC,* 2014 SEC LEXIS 938, *35 n.46 (*citing Atlas Roofing*); *Vladlen "Larry" Vindman,* 2006 SEC LEXIS 862, *44 n.60 (Apr. 14, 2006) (rejecting argument that ALJ's imposition of the civil penalty violated respondent's Seventh Amendment right to a jury trial); *Michael Tennenbaum*, 1982 SEC LEXIS 2434, *21-22 (Commission Op., Jan. 19, 1982) (finding respondent's argument that the ALJ could not assert "clearly penal sanctions" without affording the procedural safeguards of a jury trial "wholly lacking in merit"); *Hausmann-Alain Banet*, 2014 SEC LEXIS 361, *14 n.9 (Initial Decision, Jan. 30, 2014) (no jury trial right in administrative proceedings).

Atlas Roofing and its progeny clearly establish that trial by jury is not a fundamental right in the context of administrative proceedings. Yet Respondents fail to even mention *Atlas Roofing* in this section of their Brief, let alone try to distinguish it, even though it is controlling Supreme Court precedent. *See* Resp. Br. at 13-17. Respondents also fail to discuss or even mention in this section the long line of Commission cases that follow *Atlas Roofing*. Because the use of administrative proceedings that lack juries does not violate the Seventh Amendment at all, the decision to proceed administratively is not one that is subject to strict scrutiny analysis for purposes of deciding an equal protection challenge that is grounded on the alleged deprivation of Seventh Amendment rights. Respondents have not cited any authority to the contrary.

2. Respondents Cannot Sustain a "Class of One" Claim

Respondents further claim that the "[s]taff's arbitrary decision to send them into the administrative process" deprived them of equal protection, and that because "the SEC has sued other identical targets in federal court" they have a "class of one" equal protection claim. Resp. Br. at 17. This contention is also without merit.

To sustain a "class of one" equal protection claim, Respondents must show that they have "been intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treatment." *Village of Willowbrook v. Olech*, 528 U.S. 562, 564

(2000) (*per curiam*). Respondents have made no such showing in this case. First, although Respondents have identified other allegedly similarly situated defendants whom the Commission sued in federal court, they have failed to show how each of these defendants is so similarly situated to Respondents as to raise an equal protection challenge. Parties asserting "class-of-one" equal protection claims must show an "*extremely high degree of similarity* between themselves and the persons to whom they compare themselves." *Lieberman v. City of Rochester*, 2014 U.S. App. LEXIS 4347, *39 (2d Cir. Mar. 7, 2014) (emphasis added) (citing *Ruston v. Town Bd. for Town of Skaneateles*, 610 F.3d 55, 59 (2d Cir.)). *See also Missere v. Gross*, 826 F. Supp. 2d 542, 561 (S.D.N.Y. 2011) ("class of one" challenge requires showing an extremely high degree of similarity between claimants and the persons to whom claimants compare themselves).

Here, Respondents have simply pointed to other cases where individuals were charged under the same statutory provisions in federal district court. They have not shown that any of these other individuals were similarly situated to themselves, let alone how they were similarly situated for purposes of establishing the high degree of similarity necessary to sustain an equal protection challenge. As the Commission recently said in rejecting a similar equal protection challenge, "superficial comparisons to a few other proceedings fall short of establishing a colorable equal protection violation." *Harding*, 2014 SEC LEXIS 938 at *32-33.

Second, to sustain a "class of one" equal protection challenge, the Respondents must show that they were *intentionally* treated differently from others who are similarly situated. Respondents have made no such showing. The Commission recently held that respondents' constitutional claim was facially defective because respondents "identify no evidence to support their allegations that, by bringing this case as an administrative hearing, the Division *intentionally deprived them* of procedural safeguards afforded to similarly situated persons ...." (emphasis added). *Harding*, 2014 SEC LEXIS 938 at *35 n.46 (Order Den. Pet. for Interlocutory Review, Mar. 14, 2014). Respondents here similarly fail to identify any evidence that the intention of the Division when bringing this case against them as an administrative proceeding was to deprive them of procedural safeguards afforded to other persons.

Respondents claim that their situation is similar to that of Rajat Gupta, who brought an action in federal court against the Commission seeking declaratory and injunctive relief because he had been sued in an administrative proceeding rather than a federal court action. Resp. Br. at 18-19. The district judge found that Gupta sufficiently established a "class of one" claim. *Gupta*, however, is entirely different from the Respondents' case. In *Gupta* there were twenty-eight other defendants connected to the same insider trading ring who previously had been sued in federal district court and only Gupta was charged in an in administrative proceeding. Here there are no other defendants connected to the same allegations of misconduct as the Respondents who have had their cases brought in federal court rather than in administrative proceedings. *See Harding*, 2014 SEC LEXIS 938 at *33 n.42 (describing *Gupta* as "declining to dismiss complaint alleging an equal protection violation where there existed 'a well-developed public record of Gupta being treated substantially disparately from *28 essentially identical* defendants'"). To the contrary, JTF and Belesis were part of this same administrative proceeding.

Because Respondents have failed to show that they have been intentionally treated differently than other similarly situated persons, their "class of one" argument cannot be sustained.

E. The Dodd-Frank Provisions Authorizing Civil Penalties in Administrative Proceedings Do Not Violate the Seventh Amendment

In addition to the above argument that bringing an administrative proceeding violates Respondents' equal protection right by depriving them of their Seventh Amendment right to a jury trial, Respondents separately argue that the provisions of Dodd-Frank which authorize the imposition of civil penalties against unregistered persons in administrative proceedings directly violate the Seventh Amendment right to a jury trial. Resp. Br. at 19-21.

As discussed above, it is well settled that the Seventh Amendment right to a jury trial does not apply in administrative proceedings. *See Atlas Roofing*, 430 U.S. 442. While this time acknowledging the holding in *Atlas Roofing*, Respondents claim that the penalty authority enacted under Dodd-Frank violates the Seventh Amendment because it is indistinguishable from the penalty authority at issue in *Tull v. United States*, 481 U.S. 412 (1987), where the court found the Seventh Amendment right to a jury trial applied in a government action to impose penalties pursuant to the Clean Water Act. Specifically, Respondents claim that:

> In giving the SEC unprecedented power to assess the [sic] civil penalties that are punitive in nature and are imposed under a separate statutory provision focused exclusively on adjudicating liability for penalties (in contrast to a statutory provision, such as the one before the Supreme Court in *Atlas Roofing*, where penalties are intertwined with remedial measures), Dodd-Frank transformed the SEC administrative enforcement program ... into a penalty-collection program that is indistinguishable from the Water Act penalty program before the Supreme Court in *Tull*.

Resp. Br. at 21.

This is a misreading of both *Tull* and *Atlas Roofing*. Contrary to Respondents' claim, the statutory scheme authorizing relief in *Atlas Roofing* was not materially different from the one at issue in *Tull*. Rather, the distinguishing feature between *Atlas Roofing* and *Tull* was simply the forum in which the case was brought. *Tull* stands for the proposition that when the government seeks to impose civil penalties *in a federal district court action*, the Seventh Amendment right to a jury trial applies. *Atlas Roofing* stands for the proposition that the Seventh Amendment right to a jury trial does not apply when the government brings an enforcement proceeding *in an administrative forum*, even when the government is seeking civil penalties. As the court in *Atlas Roofing* stated: "when Congress creates new statutory 'public rights,' it may assign their adjudication to an administrative agency with which a jury trial would be incompatible without violating the Seventh Amendment[]." The court continued, "[t]his is the case even if the Seventh Amendment would have required a jury where the adjudication of those rights is assigned to a federal court of law instead of an administrative agency." *Atlas Roofing* at 455.

Tull did not overrule *Atlas Roofing* or alter its essential holding. Claims similar to Respondents' have been raised and rejected in previous administrative proceedings. For example, in a case in which respondents relied on *Tull* in arguing that imposing penalties in an administrative proceeding would violate their Seventh Amendment rights, Judge Foelak held:

> *Tull* does not apply to the Division's claim for civil monetary penalties because the claim in *Tull* was brought before a tribunal that offered a jury trial and the majority of the government's claim consisted of the monetary penalty. Further, in *Atlas Roofing Co., v. Occupational Safety and Health Review Commission*, 430 U.S. 442 (1976), the court held that an administrative agency has the authority to adjudicate a monetary penalty when Congress creates a new "public right" and vests the initial fact finding authority in a government agency. This is true, even though the Seventh Amendment would require a jury trial if a court was designated to hear the claim instead of an administrative agency.

Vladen "Larry" Vindman, Order Den. Mot. to Dismiss Claim for Civil Monetary Penalties, AP File No. 3-11247 (Feb. 17, 2005) (unreported). *See also SEC v. Kopsky*, 537 F. Supp 2d 1023 (2008) (E.D. Missouri) (applying *Tull* in SEC federal district court action). The new remedies authorized under Dodd-Frank come squarely within the holding of *Atlas Roofing*.

F. The ALJ Properly Imposed Penalties

Respondents argue that the ALJ improperly imposed monetary penalties on Respondents for conduct that predated the effective date of the Dodd-Frank, which was enacted in July 2010, in violation of the principle that a statute will be presumed not to allow the imposition of penalties retroactively, unless the statute specifically so provides. Resp. Br. at 35-36. This argument fails for two reasons.

First, as the OIP makes clear, this action is both a "Cease and Desist Proceeding" (brought under Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 203(k) of the Investment Advisers Act of 1940 ("Advisers Act")), and an "Administrative Proceeding" (brought under Section 15(b) of the Exchange Act, Section 9(b) of the Investment Company Act of 1940 ("Company Act"), and Sections 203(e)-(f) of the Advisers Act). *John Thomas Capital Management Group LLC*, 2013 SEC LEXIS 922 (Mar. 22, 2013). The enhanced penalty provisions of Dodd-Frank apply only to cease and desist proceedings. Civil money penalties have been available in administrative proceedings since 1990, twenty years before the enactment of Dodd-Frank, when Congress passed the Securities Enforcement Remedies and Penny Stock Reform Act (Pub. L. No. 101-429, 104 Stat. 931, 949-51) ("Remedies Act"). The Remedies Act amended the Exchange Act, the Company Act, and the Advisers Act to authorize the Commission to impose civil penalties in administrative proceedings (as well as in actions brought in federal court).[11]

[11] To the extent that Respondents are suggesting that the Division could not have brought an administrative proceeding against them prior to Dodd-Frank because they were not registered investment advisers (and therefore, could not have obtained penalties against them prior to Dodd-Frank), that would also be incorrect. *See Teicher v. SEC*, 177 F.3d 1016, 1017-19 (D.C. Cir. 1999) (affirming the Commission's authority to bring administrative proceedings against all investment advisers, whether registered or unregistered); *Vindman*, 2006 SEC LEXIS 862 (Commission Op., Apr. 14, 2006) (penalty

Thus, in *Vindman*, the Commission affirmed the ALJ's authority to issue a penalty against a non-registered stock promoter. 2006 SEC LEXIS 862 (Commission Op., Apr. 14, 2006). *See also SEC v. J.W. Barclay & Co.*, 442 F.3d 834, 847 (3d Cir. 2006) (pre-Dodd Frank case noting that Commission can assess monetary penalties in administrative proceedings); *SEC v. Gabelli*, 2010 U.S. Dist. LEXIS 27613, *30 (S.D.N.Y. Mar. 17, 2010) (noting that Remedies Act allows Commission to seek civil penalties in administrative proceedings), *rev'd in part on different grounds*, 653 F.3d 49 (2d Cir. 2011), *rev'd on different grounds*, 133 S.Ct. 1216 (2013); *aff'd in part, rev'd in part on different grounds*, 2013 U.S. App. LEXIS 9128 (2d Cir. 2013); *SEC v. Bolla*, 550 F. Supp.2d 54, 60 (D.D.C. 2008) ("Remedies Act ... which governs monetary penalties in administrative proceedings before the SEC's administrative law judges – explicitly provides such penalties").

Second, even if it is correct that Dodd-Frank penalties cannot be applied retroactively in cease and desist proceedings, the violative conduct at issue here continued after the July 2010 effective date of Dodd-Frank, as the ALJ noted in the ID. The ALJ found the misconduct consisted of three courses of actions: "violations arising from the material misrepresentations and omissions relating to (1) the life settlement component of the Funds' investments; (2) the corporate investment component of the Funds' investments; and (3) Respondents' relationship with JTF/Belesis." ID at 33. Each of these courses of action continued after July 2010, when the Respondents continued to manage the Funds' equity and life insurance investments, sent communications to investors, and maintained their working relationship with JTF and Belesis. There is, therefore, ample basis to support the imposition of a penalty pursuant to Dodd-Frank,

against unregistered stock promoter); *Zubkis*, 2005 SEC LEXIS 3125 (Commission Op. Dec. 2, 2005) (barring an unregistered associated person of an unregistered broker-dealer from association with a broker or dealer).

and indeed, as discussed below, even greater penalties than the ALJ imposed are appropriate and in the public interest.

G. Respondents' Due Process Rights Were Not Violated Because of their Inability to Assert Counterclaims or to Develop an Evidentiary Record for Such Counterclaims

Respondents also claim that their rights to due process were violated because of their inability to assert counterclaims for constitutional violations and their inability to develop an evidentiary record of such violations in an administrative proceeding. Resp. Br. at 32-34.

The Commission already has disposed of this due process claim in its Order Denying Motion to Stay Administrative Proceeding, dated February 20, 2015, noting that while the ALJ did deny Respondents requests for additional subpoenas to address their various claims, the Commission has the authority to direct that the record be supplemented and to allow supplemental briefing, or to remand to the ALJ for further proceedings. Order at 5-6. The Commission also noted that even if the Commission ultimately rejects the Respondents' attempts to expand the record and rules against them, a reviewing court can always remand the case to the Commission for further proceedings, including the taking of further evidence. Order at 6. Because there are adequate procedures on review for supplementing the record should it be found wanting in any respect necessary for a proper adjudication of the Respondents' claims, the ALJ's decision to deny further discovery did not violate Respondents' due process rights.

H. Respondents' Due Process Rights Were Not Violated Because of the Allegedly "Truncated" Duration of the Proceedings

Respondents claim that their rights to due process were violated because they lacked sufficient time to prepare for their defense. Resp. Br. at 34-35. They claim that they only had an opportunity to review a "miniscule percentage of the evidence" while the Division had years to review the same documents. Resp. Br. at 34-35. This contention distorts the truth. First, Respondents were provided with all non-privileged material in an electronically searchable Concordance format (well beyond the requirements of the Rules of Practice). This provided Respondents a quick and easy way to sort through documents and prepare their defense. Second, the majority of the documents at issue were provided to the Division by Respondents themselves -- these were the Respondents' own documents produced to the staff in response to investigative subpoenas and document requests. Respondents are uniquely situated to know their contents. Third, Respondents had ample time to prepare and even received several adjournments. Fourth, any prejudice to the Respondents was of their own making. The investigation of this matter went on for two years, during which time Respondents had to review the documents in question in order to comply with the Division's subpoenas and document requests and to prepare for testimony. Shortly after the OIP was filed, Respondents replaced their counsel with lawyers who were entirely unfamiliar with the record. To argue that they were ambushed at the last moment is disingenuous.

II. <u>Challenges to the ALJ's Factual Findings and Legal Conclusions</u>

Rule of Practice 450 provides that "[e]xceptions shall be supported by citation to the relevant portions of the record, including references to the specific pages relied upon, and by concise argument including citation of such statutes, decisions and other authorities as may be relevant." As a general matter, Respondents have not complied with Rule 450 with respect to all of the claimed exceptions. Pages 36-50 of Respondents' Brief, which comprises Respondents' entire discussion of the purported erroneous evidentiary rulings, findings of fact, and conclusions of law, does not contain a single citation to any Commission decision or other precedent. And even after the Commission ordered an additional submission to comply with Rule of Practice

450, Respondents still have failed to provide any precedent for their arguments that the ALJ made erroneous rulings. Moreover, most of Respondents' citations to the record do not relate to the ALJ's factual findings that are being contested. For these reasons, the Commission should reject Respondents' exceptions. As described below, however, the ALJ was correct with respect to her evidentiary rulings, findings of fact, and conclusions of law.

A. The ALJ's Evidentiary Rulings Were Correct

1. Business Records were Properly Admitted

The Commission has repeatedly held that law judges have broad discretion in deciding whether to admit or exclude evidence. *See, e.g., Anthony Fields, CPA*, 2015 SEC LEXIS 662 *30 n.32 (Commission Op. Feb. 20, 2015); *Toby G. Scammell*, 2014 SEC LEXIS 4193 *38-39 (Commission Op. Oct. 29, 2014); *Ronald S. Bloomfield*, 2014 SEC LEXIS 698 *38 (Commission Op. Feb. 27, 2014). Respondents argue in their moving brief and additional submission that the ID should be rejected on appeal because the ALJ's findings were based, in part, on documents that were accepted into evidence in reliance on facially defective business record affidavits. Nowhere, however, do Respondents describe why they believe the business record affidavits were defective or cite any authority to demonstrate that these affidavits were defective.

The ALJ admitted the sworn declarations of each of the following: the Wells Fargo custodian of records, Frank Larthey; the MFR P.C. custodian of records, Landie Lacayo; the AlphaMetrix 360 LLC chief of staff and chief compliance officer, Victoria Adams; the Christiana Trust vice president and group manager of corporate trusts, Lori Cooney; Life Settlement Solutions secretary and general counsel, Karen Canoff; and JTF chief compliance officer, Joseph Castellano. DX 113-117. Each of these declarations made clear that the signor was either the custodian of records or was familiar with the recordkeeping practices and systems of their institution. And each of the declarations certified that the records produced pursuant to subpoena during the Division's investigation were (1) made at or near the time of the occurrence of the matters set forth therein; (2) kept in the course of regularly conducted business activity; and (3) made as a regular practice as part of regularly conducted business activity.

The ALJ's decision to admit the business record declarations and the documents produced pursuant to those declarations was permissible. The Commission has repeatedly stated "that the Federal Rules of Evidence, including the rules on hearsay, are not applicable to our administrative proceedings which favor liberality in the admission of evidence. Under the Commission's Rule of Practice 320, a law judge may receive all relevant evidence and shall exclude evidence that is irrelevant, immaterial, or unduly repetitious. Moreover, in deciding when to admit and whether to rely on hearsay evidence, its probative value, reliability, and the fairness of its use must be considered. In doubtful cases, we have expressed a preference for inclusiveness." *Del Mar Financial Services, Inc.*, 2003 SEC LEXIS 2538, *29 (Commission Op., Oct. 24, 2003); *see also Anthony Fields*, CPA, 2015 SEC LEXIS 662, *84-85 (Commission Op.. Feb. 20, 2015) ("hearsay is admissible in administrative proceedings"); *Calais Resources, Inc.*, 2012 SEC LEXIS 2023 *14 (Commission Op., June 29, 2012) (same). The signed, sworn declarations were reliable, and as such, support the authenticity of the documents as business records.

Even under the Federal Rules of Evidence, these declarations were valid and met the requirements of Rule 803. While Respondents do not state why the declarations were defective, at the hearing they suggested that some of the declarations were defective because they were not signed by the custodian of records but, instead, by another employee such as the general counsel or chief compliance officer. The federal rules, however, do not require that a business records declaration be signed by the actual custodian of records. Rather, Rules of Evidence 803(6)(D) and 902(11) both allow testimony or declarations by either the custodian "or another qualified person." On the face of the declarations, the chief compliance officers, general counsels and other administrators were qualified persons. Indeed, in the case of a broker dealer such as John Thomas Financial, which is required under law to maintain documents, the chief compliance officer would keenly be aware of the firm's record keeping policies and procedures.[12e]

2. The Subpoenas to Investors and Belesis were Properly Limited

On Friday evening, November 8, 2013 (6:47 pm), with the hearing scheduled to start on November 18, 2014, Respondents first requested that subpoenas *duces tecum* be issued to six investors that the Division had identified on its witness list, as well as to Belesis. The subpoenas called for the production of voluminous documents by Friday, November 16. On November 12, 2013, the Division objected to the subpoenas as being untimely and burdensome; if issued, the subpoenas would give the witnesses a mere day or two to gather all of the documents. The Division noted that the Respondents had known the identities of the Division's witnesses since

[12] Respondents also argue, without citation, that the Division did not demonstrate that the declarants whoe signed the business record declarations were unavailable. Consequently, they argue that the declarations are themselves hearsay and should have been excluded. Respondents' argument is nonsensical. The point of business record declarations is to avoid the often unnecessary cost and waste of time that would occur if the custodian of records was required to testify at trial. Indeed, courts have held that business record declarations are not "testimonial" as the purpose is not to "establish or prove some fact at trial" but simply to authenticate the records. *See United States v. Yeley-Davis*, 632 F.3d 673, 680 (10th Cir. 2011); *United States v. Anekwu*, 695 F.3d 967 (9th Cir. 2012). The Division provided written notice that it wase going to use the declarations as the Division's exhibit list included such certifications. Respondents coulde have requested that the ALJ issue subpoenas for these individuals so they could challenge the declarationse if they believed the declarations were deficient. Despite this advance notice, Respondents did not requeste any subpoenas or otherwise attempt to call the declarants as witnesses. FRE 902(11) only requires thate the proponent of the business record declaration provide notice and make the declaration and the recordse available for inspection by the adversary. The Division complied with this requirement.e

October 28.[13] On November 12, the ALJ issued an order modifying the subpoenas to the investors and to Belesis to exclude production of tax returns and account statements. The ALJ held that those items contained personal information that was irrelevant to the expected testimony or any issue in the proceeding, and requiring production would be unreasonable and oppressive.

Respondents argue that the ALJ's order modifying the subpoenas was in error because "[t]hese witnesses' status as 'accredited' and 'sophisticated' and risk-tolerant investors were an issue in this case." Resp. Br. at 37. This is incorrect. The OIP does not allege that the interests in the Funds were sold to non-accredited investors. Nor does the OIP allege that investment in the Funds was unsuitable for the investors. Rather, the OIP claims that Respondents made fraudulent representations to the investors concerning the manner in which the Funds would be managed, the assets valued, and the relationship with JTF and Belesis. To the extent that the investors' sophistication might relate to the issue of whether they reasonably relied on Respondents' false statements, reliance is not an element the Division must prove. *See, e.g., Anthony Fields, CPA*, 2015 SEC LEXIS 662, *16, n.9 (Commission Op., Feb. 20, 2015); *John P. Flannery*, 2014 SEC LEXIS 4981, *46 n.64 (Commission Op., Dec. 15, 2014). Moreover, even if it were error for the ALJ to modify the subpoenas to exclude some documents, it was a harmless error as Respondents admitted into evidence the subscription agreements for the three investors who testified, which contained acknowledgments that they were all accredited investors (RX 31, 38, 69, 7), and the investor witnesses testified and were cross-examined about their investment history. Tr. 706-07, 836-37, 1350-51, 1431-34.

[13] Respondents claim that the ALJ made this determination on her own motion without the Division taking action. This is false, and is belied by the ALJ's order, which specifically states "[u]nder consideration are subpoenas duces tecum requested by JTCM/Jarkesy and a brief November 12, 2013, email from the Division of Enforcement (Division) objecting to the subpoenas as 'untimely and burdensome."

Respondents also argue, without citation, that "in a case where penalties are sought, the level of the investor vulnerability versus sophistication is relevant to any analysis of the degree of egregiousness of conduct." Resp. Br. at 37-38. However, in determining whether a penalty is in the public interest, the Commission considers: "(1) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the harm to other persons resulting either directly or indirectly from such act or omission; (3) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior; (4) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in section 15(b)(4)(B) of this title; (5) the need to deter such person and other persons from committing such acts or omissions; and (6) such other matters as justice may require." Section 21B(c) of the Exchange Act.

Similarly, the level of penalty at the third tier is determined based on whether the act or omission (a) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and (b) directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission. Section 21B(b)(3) of the Exchange Act. The sophistication of the victim is not mentioned anywhere in the statute as a factor in determining the amount of the penalty. Importantly, the ALJ did not consider the investors' lack of sophistication in determining the amount of the penalty in this case. Rather, the aggravating factors the ALJ considered were (1) fraud; (2) harm; and (3) the abuse of the fiduciary duty.

It also was proper for the ALJ to modify the subpoena to Belesis to exclude his personal tax returns and personal account statements, as these documents had no bearing on the issues at the hearing. Respondents argue that the relative culpability of the settling respondents versus themselves was an issue at the hearing, but they do not explain how Belesis' personal financial information related to the parties' relative culpability.[14] Resp. Br. at 38. Respondents also argue e that "numerous financial transactions involving all respondents were at issue, and Respondents were left to try to defend the case without access to the records for those transactions." This is not so. The OIP concerns transactions entered into by the Funds controlled by Respondents and fees improperly paid to JTF. It does not concern financial transactions entered into by Belesis personally or what taxes he paid.

[14] In their post-hearing brief, Respondents argued that the penalty sought by the Division against them was disproportionate to the penalty ordered against Belesis and JTF. This argument was groundless as Respondents cannot be compared to the settling respondents. First, the alleged facts against each are different. Respondents engaged in valuation fraud in which there is no evidence of Belesis' or JTF's role. Moreover, the misrepresentations in the sales and marketing materials were prepared by Respondents, not Belesis or JTF. Second, the charges are different. Belesis and JTF were charged solely as aiders and abettors, while Respondents were charged as primary violators in addition to being aiders and abettors. Third, Belesis and JTF settled their claims, while Respondents chose to litigate; it is well-established that it is inappropriate to compare remedies pursuant to a settlement and remedies sought in a litigated matter. *SEC v. Monterosso,* 2014 U.S. App. LEXIS 3891, *30 (11th Cir., Mar. 3, 2014) (disproportionate argument "unavailing, because Lynch chose not to settle with the SEC as to penalties and he had a different role in the scheme than his co-defendants"); *VanCook v. SEC*, 653 F.3d 130, 144 (2d Cir. 2011) (affirming Commission's order on penalties stating that "other individuals chose to settle with the SEC, whereas VanCook chose to litigate"); *SEC v. Razmilovic*, 822 F. Supp.2d 234, 281 (E.D.N.Y. 2011) ("the compromised amount of the civil penalties imposed upon Razmilovic's co-defendants in this case have no bearing upon the appropriate amount of any penalty imposed upon him"), *aff'd in all relevant parts*, 738 F.3d 14 (2d Cir. 2013) ("we reject Razmilovic's proportionality challenge because we see no othere similarly situated codefendant"), *cert. den.*, (March 24, 2014).e

3. The Subpoenas to the SEC were Properly Quashed

On February 13, 2014, ten days after the hearing commenced, Respondents requested subpoenas directed to the Commission's Office of General Counsel and Custodian of Records. In these subpoenas, Respondents requested documents concerning the settlement between the Commission and Belesis and JTF, including communications between the Division and the Commission concerning the settlement; documents concerning the decision to initiate this proceeding as an administrative proceeding instead of a federal court proceeding; and the standards applied by the Commission for determining whether to initiate an administrative proceeding as opposed to a federal court proceeding. Respondents themselves have characterized this subpoena as requesting documents concerning their "constitutional claims." On that same date the Division objected to the issuance of the subpoenas on the grounds that they called for the production of documents that are subject to numerous privileges, including the attorney-client privilege, and that they called for the production of information with no relevance to this hearing. The Division further objected on grounds that the request was not timely and should have been made prior to the commencement of the hearing.

On February 14, 2014, the ALJ declined to issue the requested subpoenas finding as follows:

> First, they are untimely. While no deadline was set for the submission of subpoena requests, the subpoenas specify a large quantity of documents and were requested ten days after the commencement of the hearing, so they are untimely as a general matter. Additionally, were JTCM/Jarkesy to obtain and serve the subpoenas, this would be accomplished, at the earliest, during the week of February 18, 2014, and the Division and any person to whom the subpoenas are directed, or who is an owner, creator, or subject of the documents to be produced, are allowed fifteen days from the date of service to request that the subpoenas be quashed. See17 C.F.R. § 201.232(e)(1). By that time, the hearing and record will have been closed. Second, aside from their untimeliness, the subpoenas are unreasonable. Subpoena No. 1 specifies evidence largely consisting of privileged internal Commission deliberations concerning the JTF/Belesis Settlement and concerning the institution of this proceeding against JTCM Jarkesy. Documents

specified in Subpoena No. 2 relate to the topics enumerated in Subpoena No. 1. Accordingly, the subpoenas will not be issued.

2014 SEC LEXIS 564, *2 (Order of ALJ Foelak declining to issue subpoenas, Feb. 14, 2014).

The ALJ's reasoning was correct. There were additional and compelling reasons, however, why the subpoenas should have been quashed. On January 28, 2014, the Commission denied Respondents' Petition for interlocutory appeal, holding that an unbroken line of Commission decisions had established that "'consideration of [certain respondents'] offer of settlement while the proceedings were still pending against ... other respondents [is] proper and [does] not violate the Administrative Procedure Act ... or our rules regarding ex parte communications.' In particular, the Commission has determined previously that no prejudgment of a non-settling respondent's case occurs . . . ." Given this unequivocal statement from the Commission, it was clear that the issues for which Respondents were seeking discovery would have no bearing in the hearing that had already started and, instead, was intended to support the case that Respondents had filed in federal district court.[15]

4. The ALJ Properly Allowed Arthur Coffey to Testify

During the first days of the hearing, Jarkesy repeatedly testified "I don't know" or "I don't recall" to the Division's questions concerning Respondents' promotional materials (including materials that Respondents had themselves produced during the investigation). In addition, Respondents' counsel repeatedly objected to the admission of the promotional materials on the grounds that (1) the Division had not established a proper foundation for the exhibits; (2) the Division could not establish the authenticity of the exhibits; and (3) the Division could not

[15] Respondents filed a separate motion with the Commission to Adduce Additional Evidence, which largely concerns the same discovery requests sought in the two subpoenas to the Commission, *i.e.*, discovery relating to Respondents' constitutional claims. The Division does not submit a separate opposition to Respondents' motion but for the reasons described herein, that motion should also be denied.

establish that the promotional materials were provided to investors. In response to Jarkesy's testimony and the objections of counsel, the Division sought to take the testimony of a JTF witness to authenticate the marketing materials, to confirm that Respondents provided them to JTF in order that they be given to investors and potential investors, and to confirm that the materials were in fact provided to investors. After a review of the investigative file, the Division determined to call Arthur Coffey ("Coffey"), the branch manager of JTF's Hauppague, Long Island office who happened to be on numerous emails where Respondents transmitted the marketing materials to JTF. On Thursday, February 20, 2014, the Division served Respondents with a supplemental witness list stating that it intended to call Coffey as a witness instead of the two other JTF witnesses who previously had been identified, and requesting that the ALJ issue Coffey a hearing subpoena. Respondents filed an emergency motion to quash arguing that the subpoena request was untimely and that they would not have sufficient time to prepare a cross-examination. The Division responded, noting that Respondents had a searchable Concordance database, which would allow them to quickly find all relevant documents.

That same day, the Division sought to address the concerns that Respondents raised about the lack of time to prepare a cross-examination. The Division informed counsel for Respondents that Coffey was available to testify on either Monday February 24 or Thursday February 27.[16] Respondents informed the Division that should the ALJ allow Coffey to testify, they would prefer the 20th.[17] The ALJ permitted Coffey's testimony, and he was examined and crosse examined. Following his testimony, Respondents again complained about their lack of time to

[16] Coffee could not testify on Tuesday or Wednesday because of personal obligations.

[17] In that same communication, the Division informed Respondents that it had just received a transcript of testimony Coffey had provided in a FINRA case against Belesis and provided that transcript to Respondents.

prepare. The ALJ allowed Respondents to recall Coffey and cross-examine him a second time on Thursday, February 27, but Respondents declined to do so.

The ALJ's decision to allow Coffey to testify was proper. Unlike the untimely subpoenas that Respondents attempted to serve on the Commission (which had no bearing on the hearing), the Coffey testimony was pertinent. Moreover, Coffey's testimony was prompted by Jarkesy's evasive testimony and the objections of his counsel. While Respondents claim that they did not have sufficient time to prepare their cross-examination of Coffey, it is uncontroverted that they were on notice that some witness from JTF would be testifying. They had a searchable database (provided by the Division) that should have allowed them to quickly find all documents concerning Coffey. They had the transcript of the testimony that Coffey provided to FINRA concerning Belesis. And most important, they had a week to prepare their cross-examination. It was Respondents who chose the earlier date for Coffey's testimony, and Respondents elected not to recall Coffey as the ALJ had permitted.

5. The ALJ Properly Declined to Admit the Belesis Affidavit

Respondents did not name Belesis as a witness in this case. In early March 2014, they suggested to the Division that they would seek to introduce into evidence certain excerpts from Belesis's investigative testimony.[18] However, instead of seeking to admit the excerpts, at 11:08 p.m. on March 6, 2014, Respondents' counsel emailed the Division an affidavit signed by Belesis. The affidavit contained excerpts from Belesis's investigative testimony and stated that "if asked the following questions posed during that investigative testimony, I would give the

[18] Notably, on February 26, 2014, the Division sought to admit certain excerpts from Jarkesy's investigative testimony. Tr. 2327-2331. The Division invited the Respondents to make any counter designations. Tr. 2330-31. The ALJ did not rule on the issue at the time. On March 13, citing the Commission opinion in *Del Mar Financial Services, Inc.*, 2003 SEC LEXIS 2538 (Commission Op. Oct. 24, 2003), the ALJ allowed the excerpts into evidence. Tr. 3012-3018; DX 122. Respondents declined to counter designate parts of Jarkesy's investigative testimony.

same answers under oath today." The Division objected to the admission of this affidavit, stating that the witness was available to testify in person. On March 7, 2014, Respondents moved the affidavit into evidence, but the ALJ rejected it, stating that "[t]he affidavit is off the table." Tr. 2821. Respondents' counsel replied that she would call Belesis as a witness, *id.*, and the ALJ ordered that Respondents should inform the Division by 5:30 p.m. if they were going to call Belesis as a live witness. Tr. 2822-23. On March 7, at 5:30 pm, Respondents' counsel informed the Division that they intended to call Belesis to provide testimony.

On March 13, 2014, Respondents' counsel once again brought up the Belesis affidavit and stated that they had been informed that Belesis intended to assert his Fifth Amendment Privilege against self-incrimination and was, therefore, unavailable; thus, she said, his affidavit should be admitted. The Division argued that based on this representation, the affidavit would on its face be false. If Belesis was going to assert his Fifth Amendment privilege, he would not be giving the same answers today as his affidavit described. The ALJ again declined to admit the affidavit. Tr. 3043. On March 14, 2014, Respondents once again raised the issue with the ALJ. This time, instead of moving the affidavit into evidence, they sought admission of certain pages from Belesis' investigative testimony as had been done with Jarkesy's investigative testimony. The ALJ agreed to admit the excerpts into evidence and to allow the Division to make counter-designations, which the Division did. RX 138; Tr. 3074-75.

The ALJ's rulings were correct. Commission precedent allows excerpts from investigative testimony to be admitted into evidence. See *Del Mar Financial Services, Inc.*, 2003 SEC LEXIS 2538 (Commission Op., Oct. 24, 2003). There is no precedent, however, to create a new affidavit which does no more than quote earlier testimony, as Respondents attempted. Such an affidavit would have accorded greater weight to the testimony than warranted, particularly since Belesis had entered into a settlement with the Commission subsequent to his investigative testimony in which he agreed to not take any action to deny any finding in the Order or to create the impression that the Order was without factual basis. Moreover, as the Division argued, Belesis, in fact, was not prepared to give those answers if he was called to testify live; his counsel had informed the Division and Respondents that Belesis would assert his Fifth Amendment privilege. Finally, even if the ALJ erred by not allowing the affidavit, the error was harmless since she admitted RX 138 and Respondents were allowed to designate the same excerpts from Belesis's testimony that they were trying to introduce into evidence through the affidavit.[19]

B. The ALJ's Factual Findings Were Correct

Respondents challenge 52 of the ALJ's factual findings. As described in the spreadsheet attached hereto as the Division's Appendix, the ALJ's factual findings were supported by both the testimony and the admitted documents. In this brief, the Division addresses several common themes in Respondents exceptions.[20]

1. George Jarkesy's Credibility

In her decision, the ALJ held that "no weight has been placed on [Jarkesy's] testimony as to facts that are disputed or not corroborated by credible evidence elsewhere in the record." ID at 10. The ALJ's credibility determination was based on her view that Jarkesy "generally testified in an evasive manner that did not provide any assurances on the reliability of his

[19] Respondents' separate Motion to Adduce Additional Evidence also requests that the Belesis affidavit be considered by the Commission. Because the same issues were raised in Respondents' Opening Brief, the Division does not submit a separate brief opposing the motion, but rather requests that that motion be denied for the reasons set forth herein. Because the excerpts from Belesis's investigative testimony are already in the record through RX 138, the Commission need not consider the Belesis's affidavit.

[20] Perhaps Respondents' main argument is that the documents relied upon were not properly admitted into evidence because of a lack of foundation or lack of authenticity. As described above, these documents were properly admitted as business records pursuant to the business records declarations. And even to the extent that the documents were hearsay, hearsay evidence is not inadmissible in an administrative proceeding.

testimony." *Id.* The ALJ found that Jarkesy responded "I don't recall" or a variant of that phrase more than 800 times during his testimony" including as to basic questions. However, the ALJ noted that Jarkesy's "recollection markedly improved when questioned by his own counsel." *Id.* at 11. The ALJ stated that "Jarkesy further undermined his credibility by disclaiming responsibility for representations made in the PPMs, financial statements, marketing materials, and newsletters ...." *Id.* In their appeal, Respondents attack the ALJ's determination of Jarkesy's credibility in two respects: First, they argue that the credibility determination itself was incorrect. Second, in arguing that other factual findings of the ALJ were incorrect, they cite the testimony of Jarkesy as evidence to the contrary.

While the Commission's review is *de novo*, it is well-established that "considerable weight and deference" should be accorded to an ALJ's credibility determinations. *See, e.g., Montford and Co., Inc.*, 2014 SEC LEXIS 1529, *81 (Commission Op., May 2, 2014) (citing *Robert M. Fuller*, 2003 WL 22016309, *7 (Aug. 25, 2003) ("We give considerable weight to the credibility determination of a law judge since it is based on hearing the witnesses' testimony and observing their demeanor. . . . Such determinations can be overcome only where the record contains 'substantial evidence' for doing so.")); *Michael R. Pelosi*, 2014 SEC LEXIS 1114, *6-7 (Commission Op., March 27, 2014) (same); *William J. Murphy*, 2013 SEC LEXIS 1933, *54 (Commission Op., July 2, 2013) (same). Respondents do not provide substantial evidence for overturning the ALJ's credibility determination. Indeed, notwithstanding that the Commission's January 20, 2015 Order, taking Respondents to task for failing to do anything more than provide conclusory challenges to the ALJ's factual findings, Respondents still fail to cite any evidence to counter the ALJ's credibility determination. *See* Respondents' Additional Submission, Nos. 30-31. Respondents only citation to the record is the ALJ's comment that there was a contrast between Jarkesy's testimony when he was answering the Division's questions and when he was answering his own counsel's questions. Tr. 2689-90. This is not "substantial" evidence. Indeed, the ALJ's statement only confirmed what was obvious to all who were present at the hearing.

For these reasons, the Commission should not overturn the ALJ's credibility determination concerning Jarkesy. Moreover, to the extent that Respondents argue that a factual finding was incorrect because the ALJ failed to consider contrary evidence – and that contrary evidence is Jarkesy's uncorroborated testimony – the Commission should also not overturn that factual finding.

2. The Authorization to Change the Strategy of the Funds

In their moving brief and their additional submission, Respondents argue that many of the ALJ's factual determinations were incorrect because the PPMs gave Respondents the ability to change the investment strategy for the funds, including changing professionals such as auditors. For example, Respondents argue that the ALJ's determination that Fund I did not meet its obligation over its life to maintain insurance policies with a face value of 117% of the money invested was erroneous because they had express authority to change business plans and asset mix. Resp. Additional Submission Nos. 48-49. Likewise, Respondents argue that the ALJ made erroneous conclusions regarding the role of KPMG and Deutsche Bank and the representations about them to investors because they had express authority to change professionals. The fallacy of this argument, however, is that while Respondents may have had some ability to change strategy, there is no evidence that they did so. At no point in his testimony did Jarkesy ever claim that he changed the investment strategy, and there are no documents in evidence that suggest he did. There is no evidence that the PPM for Fund I was ever amended to remove the 117% requirement for life insurance coverage or the 5% investment limitation.

To the contrary, the documents sent to investors uniformly describe the same investment strategy. Respondents continually represented throughout the life of the Funds that they were investing half of the money in insurance policies and that they had purchased policies with a face value of at least 117% of capital invested. *See, e.g.*, DX 260 (March 2009); DX 220 (May 2009); DX 262 (June 2009); DX 637 (July 2009); DX 221 (March 2010); DX 259 (June 2010); DX 248 (August 2010). During the podcast, Respondents emphatically reiterated the 117% coverage requirement: "Our charter requires that we have 117 percent of the value of our investor cash in face value life settlement policies. We do this not to make money. We do it, because at the end of the fund, we want our investors to have some assurance that they get their money back." DX 203 at 3. Likewise, Respondents repeated that they were limited to a 5% investment in a single company. DX 214-217; DX 258. The authorization to change strategy is thus a red-herring. Even assuming that Respondents had secretly changed investment strategies, telling the investors and prospective investors that your strategy is one thing while you are doing another is, quite blatantly, fraud.

Moreover, there is a fundamental difference between an investment strategy and an "investment limitation" such as the 5% limitation. If "investment limitations" could be changed at will, then they really would not be limitations at all. *See Rochester Funds Group Sec. Litig.*, 838 F. Supp.2d 1148, 1171-72 (D. Colo. 2012) (rejecting defendants' interpretation of the limitation, stating that such an interpretation would "convey[] no meaningful information and certainly no meaningful assurances to prospective investors. Yet the statements clearly suggest that something real is being warranted").

3. Reliance on Counsel

During the hearing and to some extent in their papers on appeal, Respondents claimed that the materials sent to investors (including the PPMs and the promotional materials) were reviewed by counsel. Because they claim to have relied on counsel's advice, they argue that they did not have the necessary scienter to violate the securities laws. Respondents, however, asserted the attorney client privilege during the investigation as grounds for withholding documents and, therefore, cannot now assert the attorney client privilege as a defense or as a mitigating factor.[21]

Even if their assertion of the privilege does not preclude them from arguing reliance on counsel, it is clear that Respondents have not met their burden. In considering whether to credit an advice of counsel claim, the Commission considers four elements: "that the person made complete disclosure to counsel, sought advice on the legality of the intended conduct, received advice that the intended conduct was legal, and relied in good faith on counsel's advice." *Howard Brett Berger*, 2008 SEC LEXIS 3141, *38 (Commission Op., Nov. 14, 2008), *pet. for review den.*, 347 F. App'x 692 (2d Cir. 2009), *cert denied*, 559 U.S. 1102 (2010). In *Berger*, the Commission described the evidentiary burden that a respondent must meet in order to assert reliance on counsel:

> We believe that the respondent asserting such reliance must provide sufficient evidence to the body making the sanction determination that the respondent made full disclosure to counsel, appropriately sought to obtain relevant legal advice, obtained it, and then reasonably relied on the advice. Courts consider it important that "the advice of counsel [the client] received was based on a full and complete

[21] *SEC v. Wyly*, 2011 U.S. Dist. LEXIS 87660, *5-6 (S.D.N.Y. July 27, 2011) ("A client who claims that he acted on advice of counsel cannot use the privilege to prevent inquiry into the communications that the client and lawyer had about that advice. There is a compelling notion that the adversary "cannot be stonewalled by the simultaneous assertion of the [advice of counsel] defense and the privilege." Put another way, the attorney-client privilege can be used to shield information, but it cannot be used as a sword against the adversary.")

> disclosure." Further, it "isn't possible to make out" an advice-of-counsel claim "without producing the actual advice from an actual lawyer." The Seventh Circuit rejected a defendant's argument that "reliance on advice of counsel exculpates his conduct" because the defendant "offered nothing more than his say-so." The court noted that "[h]e did not produce any letter from a securities lawyer giving advice that reflected knowledge of all material facts; he did not produce any opinion letter, period. Nor did [he] offer the live testimony of any securities lawyer."

Id. at *40; *see also David Henry Disraeli*, 2007 SEC LEXIS 3015, *30 (Commission Op. Dec. 21, 2007) (rejecting reliance on counsel defense where "[t]he record contains no evidence that Disraeli made complete disclosures to counsel regarding his use of the offering proceeds, that he received advice that his conduct wshieas legal, and that he relied on any advice in good faith despite knowing that he did not intend to use the proceeds of the offering as described in either the October Memorandum or the December Memorandum."); *Rockies Fund, Inc.*, 2003 SEC LEXIS 2361, *72 (Commission Op., Oct. 2, 2003) ("As for the Fund's reliance on counsel, Respondents proffered no evidence that they asked for any advice or received a legal opinion about the propriety of particular actions"). Respondents in this case have not made the proper evidentiary showing. They have not described what legal advice they sought. They have not described what they told their attorneys or what their attorneys told them. And they have not demonstrated that they followed their attorneys' advice. Jarkesy's bare assertion that counsel drafted the documents or that he relied on the advice of counsel is not sufficient to meet their burden of proof.

III. <u>The Division's Arguments on Appeal: Disgorgement, Penalties and an Accounting</u>

While the Commission should uphold the ALJ's factual findings and legal conclusions, the Division respectfully requests that the Commission modify the ID with respect to the some of the sanctions and remedies. Specifically, the Division believes that the ALJ erred in calculating the appropriate amount of disgorgement and set a penalty that was far too low given the egregious nature of the conduct at issue. Finally, the Division also believes the ALJ erred in concluding that she had no legal authority to order an accounting. The legal authority for such remedy is clear, and an accounting is warranted in this case.

A. Sanctions Against the Respondents Are Appropriate and in the Public Interest

As the ALJ discussed, in weighing appropriate sanctions the Commission considers such factors as: "the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations." ID at 30 *(citing Steadman v. SEC*, 603 F.2d 1125, 1140 (5th Cir. 1979) (*quoting SEC v. Blatt*, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978))). "The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation." *Id.* (*citing Marshall E. Melton*, Exchange Act Rel. No. 48228, 2003 SEC LEXIS 1767, *4-5 (July 25, 2003)). "Additionally, the Commission considers the extent to which the sanction will have a deterrent effect." *Id.* (*citing Schield Mgmt. Co.*, 2006 SEC LEXIS 195, *35-36 & n.46 (Jan. 31, 2006)). "As the Commission has often emphasized, the public interest determination extends to the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally." *Id.* (*citing Christopher A. Lowry*, Investment Company Act Rel. No. 2052, 2002 SEC LEXIS 2346, *20 (Aug. 30, 2002), *aff'd*, 340 F.3d 501 (8th Cir. 2003); *Arthur Lipper Corp.*, Exchange Act Rel. No. 11773, 1975 SEC LEXIS 527, *52 (Oct. 24, 1975)).

Based on these factors, and the ALJ's factual findings supported by the record, Respondents should receive the most severe sanctions available. Since 2007, when Jarkesy created JTCM and Fund I, the Respondents continuously and willfully have perpetrated a fraud on some 120 investors, squandering approximately $24 million of investor assets. *See* ID at 8-24, 28-29, 31 (and citations to the record therein). The record is replete with evidence of the Respondents' intent to defraud: they made material misrepresentations or omissions regarding, among other things, the Funds' investment strategy, equity investments, insurance hedge, portfolio valuations, service providers, and relationship with John Thomas Financial, Inc. and its chief executive officer, Anastasios "Tommy" Belesis. ID at 28-29. To this day, the Respondents continue to operate the Funds, thus continuing the fraud even as the Commission weighs this appeal. *See* ID at 22; DX 247 (distribution of near-worthless, restricted shares in October 2013).

In the face of a wealth of evidence against him and JTCM, Jarkesy steadfastly denies any wrongdoing and has given no assurance against future violations. Any such assurances would not be believable, in any event; his credibility was given no weight by the ALJ, who observed his evasiveness and mendacity first hand during the hearing. ID at 10-11 (noting that he claimed "I don't recall," or a variant thereof, more than 800 times). Finally, Jarkesy's continued activity in the securities industry presents robust opportunity for him to violate the securities laws again in the future: he is chairman of the National Eagles & Angels Association, a small business organization dedicated to "creating a climate where the American business owner can soar in the current market," according to its website, www.eagleandangel.com. *See* Tr. 1295: 16-17 (Jarkesy).

Thus, the fullest panoply of the most severe sanctions is appropriate and in the public interest to deter the Respondents' conduct, to deter similar conduct of like-minded violators, and to protect investors and the integrity of the securities industry generally. *See Schield Mgmt. Co.*, 2006 SEC LEXIS 195 at *35-36 & n.46; *Christopher A. Lowry*, 2002 SEC LEXIS 2346 at *20; *Arthur Lipper Corp.*, 1975 SEC LEXIS 527 at *52.

B. The Applicable Statutory Provisions Authorize the Commission To Penalize the Respondents for Each Act or Omission That Constitutes a Violation of the Federal Securities Laws

Under Section 8A of the Securities Act, Section 21B of the Exchange Act, Section 9(d) of the Company Act and Section 203(i) of the Advisers Act, the Commission may impose civil penalties if it finds, on the record and after notice and opportunity for hearing, that a person has willfully violated any provision of the Securities Act, the Exchange Act or the Advisers Act. In considering whether a penalty is in the public interest, the Commission considers various factors including fraud, harm to others, unjust enrichment, and previous violations. Section 21B(c) of the Exchange Act; Section 9(d)(3) of the Company Act; Section 203(i)(3) of the Advisers Act. The statutes specify penalties up to the maximum amount "for each act or omission" in violation of the federal securities laws. Section 8A(g)(2) of the Securities Act; Section 21B(b) of the Exchange Act; Section 9(d)(2) of the Investment Company Act; Section 203(i)(2) of the Advisers Act.

Consistent with the plain language of these statutes, respondents in numerous Commission actions have been penalized for each violation of the federal securities laws. *See e.g., Steven E. Muth*, Initial Decision Rel. No. 262, 2004 SEC LEXIS 2320, at *118 (Oct. 8, 2004) (stating statutory maximum "is not an overall limitation, but a limitation per violation."). For example, in *Mark David Anderson* the Commission imposed ninety-six penalties against a respondent, one for each of ninety-six trades in which he charged customers an undisclosed markup or markdown. Securities Act Rel. No. 8265, Exchange Act Rel. No. 48352, 2003 SEC LEXIS 1935, at *39-40 (Aug. 15, 2003). *Accord, Kevin H. Goldstein*, Initial Decision Rel. No. 243, 2004 SEC LEXIS 87, at *52 (Jan. 16, 2004) (finding in fraudulent offering of securities that each fraudulent misrepresentation to each investor constituted a separate act or omission); *J.W.*

Barclay & Co., Initial Decision Rel. No. 239, 2003 SEC LEXIS 2529, at *114-115 (Oct. 23, 2003) (holding that each unauthorized trade and each unsuitable transaction constituted a separate act or omission); *Robert G. Weeks,* Initial Decision Rel. No. 199, 2002 SEC LEXIS 268, at *177 (Feb. 4, 2002) (finding a separate act or omission for each misrepresentation mailed to each shareholder, each sale of unregistered securities, and each failure to file required reports), *aff'd,* Securities Act Rel. No. 8313, Exchange Act Rel. No. 48684, 2003 SEC LEXIS 2572 (Oct. 23, 2003). Federal courts also have imposed multiple penalties based on a per-violation sanction. *See, e.g., United States v. Reader's Digest Ass'n.*, 662 F.2d 955, 966-67 (3d Cir. 1981) (holding that each individual mailing constituted a separate violation); *SEC v. Ramoil Mgmt., Ltd.*, 2007 U.S. Dist. LEXIS 79581, at *35 (S.D.N.Y. Oct. 25, 2007) (penalizing defendant for each false document he filed with the Commission under each statute that the false filings violated).

In this proceeding, the evidence indicates that the Respondents' violative activities began in or about 2007 and are ongoing, as they continue to manage the two Funds and purport to be winding down the older Fund's operations. *See* ID at 8, 20 (and record evidence cited therein); DX 247 (distribution of near-worthless, restricted shares in October 2013). The ID details the Respondents' material misrepresentations and omissions to 120 investors during the life of the Funds. ID at 8-24. In considering whether penalizing the Respondents was in the public interest, the ALJ found there were no "mitigating factors and several aggravating factors," including their "reckless disregard of a regulatory requirement," the "millions of dollars of losses" they visited on investors, and "the abuse of the fiduciary duty owned by investment advisers." ID at 32. She found that penalties were appropriate due to the Respondents' "fraud, harm to others, unjust enrichment and the need for deterrence." ID at 32.

Yet, after meticulously chronicling the Respondents' fraud, and acknowledging that substantial penalties were in the public interest, the ALJ paradoxically concluded the Respondents had committed only three violative acts arising from misstatements and omissions relating to (1) the life settlement component of the Funds' investments, (2) the corporate investment component, and (3) their relationship with JTF/Belesis. ID at 32-33. She viewed JTCM as Jarkesy's *alter ego* and ordered a joint and several third-tier penalty of $450,000. ID at 33. Such scant penalty is inconsistent with the ALJ's findings of fact and public interest analysis, as well as the statutory language and precedent for penalizing wrongdoers per violation.

Instead, the Respondents should be penalized separately for each of the 120 investors they willfully harmed – and continue harming – by their material misrepresentations and omissions. Maximum third-tier penalties are appropriate due to their fraud and deceit that directly or indirectly resulted in substantial losses to investors and substantial gains to themselves. *See* Section 8A(g)(2)(C) of the Securities Act; Section 21B(b)(3) of the Exchange Act; Section 9(d)(2)(C) of the Company Act; Section 203(i)(2)(C) of the Advisers Act. The Respondents' violations are ongoing for as long as the Funds exist, and thus the inflationary adjustment for post-2013 penalties is appropriate. *See* 17 C.F.R. § 201.1005.

The maximum, inflation-adjusted, third-tier penalty for a natural person such as Jarkesy, is $160,000 per violation. *See* 17 C.F.R. § 201.1005, Table V to Subpart E (reflecting inflation adjustments for conduct after Mar. 5, 2013). For a violator other than a natural person, such as JTCM, the maximum inflation-adjusted, third-tier penalty is $500,000. *See id.* Thus, calculating maximum, inflation-adjusted, third-tier penalties based on each of the 120 harmed investors, Jarkesy's penalty could be as high as $19.2 million and JTCM's penalty could be as high as $60 million.

Alternatively, the Commission appropriately may penalize the Respondents for each of the twenty-two misstatements or omissions detailed in the record. Those include the following:

■ From the Respondents' PPM and Limited Partnership Agreements: (1) the Funds would purchase insurance policies with face value of 117% of the investor capital; (2) half of all investor capital would be used to purchase the insurance policies or would be set aside and segregated to pay premiums; (3) Respondents would mitigate life expectancy risk; (4) the insurance policies would be transferred to the Master Trust; (5) the total investment of the partnership in any one company at any one time would not exceed 5% of the aggregate capital commitments; (6) the general partner, JTCM, would utilize good faith; (7) fair value would be used to value securities where no market quotation was readily available; (8) the Funds' financial statements would be prepared according to GAAP; and (9) management of the partnership would be vested exclusively in the General Partner. *See* DX 206, 210.

■ From the Respondents' marketing materials and investor updates: (10) KPMG was the auditor for the Funds; (11) Deutsche Bank was the prime broker for the Funds; (12) insurance policies would be purchased from AA rated insurance companies; (13) Fund I had purchased fourteen policies from fourteen separate insurance companies; (14) the bridge loans were be "collateralized"; and (15) valuations of the Funds' assets would be conservative. *See* DX 211, 214-222, 224, 248.

■ From the Respondents' website, (16) that JTF did not manage, direct, or make any decisions for the Funds. *See* DX 502.

■ From the Respondents' fraudulent valuation of many of the Funds' portfolio positions, including: (17) the life insurance policies, which Respondents valued using a 12% discount rate instead of the appropriate 15% discount rate; (18) the restricted stock, which Respondents valued at the same price as free-trading stock; (19) the notes of America West and Galaxy, which Respondents valued at par notwithstanding that the notes were in default; (20) the shares of Radiant and America West, which Respondents valued based upon promotional activities they paid for with money from the Funds; (21) the Radiant warrants, which Respondents valued at an arbitrary price bearing no relationship to the market price; and (22) the shares of portfolio companies like Galaxy and America West, which Respondents overvalued, given the poor financial condition of those companies. *See* DX 220, 301, 303, 305, 306(b), 306(d), 307(a), 308-312, 333, 425, 447, 455, 600, 618-619, 647; Div's Proposed Findings of Fact Conclusions of Law at ¶¶ 68-71 (and citations to the record therein).

Using this alternative calculation based on the twenty-two misrepresentations and omissions in the record, the Commission could impose an appropriate, inflation-adjusted, third-tier, per violation penalty against Jarkesy of $3.52 million and against JTCM of $11 million. The ALJ found that the Respondents managed approximately $24 million of investor money. ID at 8. Thus, combined penalties of $14.52 million based on the twenty-two incidents of material misrepresentations and omissions still would amount to a fraction of the investor assets that the Respondents managed – and lost – through their fraud, deception, and violative conduct.

C. Disgorgement Should Include Incentive Fees of More than $123,000

The Respondents should be ordered to disgorge all ill-gotten gains in the evidentiary record, including $1,278,597 in management fees and $123,338.38 in incentive fees, for a total disgorgement of $1,401,935.38. *See* DX 309 (bank account spreadsheet), DX 315-318 (audited financial statements). In concluding there was no record evidence of incentive fees, the ALJ overlooked Division's Exhibit 309. ID at 15 n.19.

As the ALJ noted, the Commission may order disgorgement of ill-gotten gains pursuant to Section 8A(e) of the Securities Act, Section 21B(e) and 21C(e) of the Exchange Act, Section 9(e) of the Company Act and Section 203(j) of the Advisers Act. Disgorgement is an equitable remedy designed to strip violators of wrongfully obtained profits and return them to their financial position before the violations. ID at 31 (*citing SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230-32 (D.C. Cir. 1989); *Hateley v. SEC*, 8 F.3d 653, 655-56 (9th Cir. 1993)). Disgorgement need not be exact, but only a reasonable approximation of profits causally connected to the violations. *Id.* (*citing, inter alia, Laurie Jones Canady*, Exchange Act Rel. 41250, 1999 SEC LEXIS 669, *38 n.35 (Apr. 5, 1999)). Management and incentive fees appropriately are disgorged where they constitute ill-gotten gains generated from violative activities. *Id.* (internal citations omitted).

The ALJ ordered disgorgement of $1,278,597 in management fees, based on her summing up the management fees for both Funds. ID at 15 (*citing* DX 315-318). She indicated that while incentive fees were referenced in the record, "there is no evidence that establishes the amount, if any, of incentive fees actually paid." ID at 15 n.19. However, the ALJ overlooked at least $123,338.38 of incentive fees from 2010 that are part of the record. *See* DX 309 at 2 (bates JTBOF 06903, $63,338.38 incentive fee on 2/3/2010), 8 (bates JTBOF 06837, $20,000 incentive fee on 8/9/2010; $10,000 partial incentive fee on 8/18/2010), 10 (bates JTBOF 07058, $30,000 quarterly incentive fee on 11/12/2010).

Inasmuch as Respondents should disgorge the management fees they earned from their fraudulent activities, they also should disgorge ill-gotten incentive fees and prejudgment interest thereon. The disgorgement that the ALJ ordered should be enhanced to include the $123,338.38 in incentive fees, for total disgorgement of no less than $1,401,935.38, plus prejudgment interest, which is a reasonable approximation of Respondents' wrongful earnings. *See First City Fin. Corp*, 890 F.2d at 1230-32; *Hateley*, 8F.3d at 655-56; *Canady*, 1999 SEC LEXIS 669 at *38 n.35.

D. An Accounting Should Be Ordered to Quantify and Safeguard Investor Assets

The Division sought an accounting of JTCM's operations and investments, but the ALJ declined to order one for want of detail and authority. ID at 32 n.39. This was in error. An accounting is explicitly authorized by statute and warranted where, as here, approximately $30 million of investor money is unaccounted for.

The ALJ found that the Respondents managed $24 million of investor assets which, at the Funds' height, was worth as much as $30 million, ID at 8, 31, but the current value of investors' assets is unknown. The Respondents have given conflicting statements of the current value of investments they manage. Jarkesy testified at the administrative hearing that he could neither identify nor quantify the Funds' assets. Tr. 63:15-16 (Jarkesy testimony, Feb. 3, 2014). Yet six days earlier, he had filed a complaint in United States District Court for the District of Columbia, where he was seeking emergency and declaratory relief to halt the administrative proceeding, claiming the Funds' then-current value was approximately $15 million. Compl. at ¶ 11, *Jarkesy v. SEC*, 1:14-cv-00114-BAH (D. D.C. Jan. 29, 2014).

Investors who testified at the administrative hearing in the spring of 2014 also were mystified by the value of their investment in the Respondents' Funds. Tr. 747:3-5 (Benkovsky, unaware of value of his investment); Tr. 822:24-823:3 (Beam, "[n]ot a clue" as to value of his investment). And while Jarkesy testified he was in the midst of obtaining an accounting, none has been rendered and/or shared with the Commission staff. *See* Tr. 63:17-24 (Jarkesy).

Respondents have been careless in accounting for investor money for years. Partnership agreements for the Funds they manage require annual auditing and GAAP-compliant financial statements, but none has been done since the end of 2010. *See* DX 206 at 44 (Fund I private placement memorandum, annual audit provision), DX 210 at 14 (Fund II private placement memorandum, annual audit provision), DX 317-318 (Funds' audited financial statements for year ended Dec. 31, 2010). Thus, for more than four years, Respondents have managed some unknown amount of investor assets without any assurance that the assets have not been wasted, dissipated or misused for improper purposes.

The authority to order an accounting is explicit in Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, Section 9(e) of the Company Act, and Sections 203(j) and 203(k)(5) of the Advisers Act. Based on this, the Commission should order an accounting that, at minimum, (1) lists the current assets of the Funds and their fair value pursuant to GAAP; (2) lists the dates that all other portfolio positions were sold, distributed, or otherwise ceased to be in the Funds and the sale price (if those positions were, in fact, sold); and (3) lists all disbursements of cash by the Funds. Such accounting would provide reasonable assurance as to the whereabouts of millions of investor dollars, would help ensure the safety of any remaining investor assets, and could provide evidence of further disgorgement to be required of the Respondents. The statutorily authorized accounting should be ordered.

CONCLUSION

For the reasons set forth herein, the Commission should deny Respondents' various constitutional, due process, and equal protection challenges, affirm the ALJ's factual findings and conclusions of law, but modify the remedies and sanction imposed by the ALJ.

Dated: As of March 13, 2015
New York, New York

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CERTIFICATE OF COMPLIANCE

I hereby certify that the text of the foregoing Division's Brief contains no more than 21,000 words as reported by the word processing system on which it was prepared, including footnotes and citations, and excluding the table of contents, table of authorities, the certificates of counsel, and attached Appendix (spreadsheet), in compliance with the Commission's Rule of Practice 450(d), 17 C.F.R. § 201.450(d) and the Commission's Extension Order issued March 3, 2015.

By:______________________
Alix Biel, Esq.

DIVISION'S APPENDIX

No.	ALJ's Actual Factual Findings	Respondent's Characterization of Findings	ALJ's Citations	Citation to the Division's Proposed Findings of Fact ("DFPOP") or Other Record Support	Respondent's Citations in Support of their Proposed Exceptions	Notes
26	Eventually, America West came to believe that JTF was an affiliate of the Funds. Walker was shocked in early 2012 when a JTF representative told him it was unnecessary for Jarkesy to participate in a conference call related to the Funds' investments in America West because he could speak for Jarkesy and, in fact, JTF and Jarkesy were partners in this and other investments and "are tied at the hip."	The ALJ erroneously concluded that an undisclosed relationship exists between Respondents and the settled respondents, John Thomas Financial ("JTF") and Anastasios Belesis ("Belesis"). Initial Decision 16. This finding is not supported by credible evidence and ignores contradictory evidence that they acted independently.	Tr. 654-65, 688-93; Div. Ex. 346 at 72.	DFPOP ¶¶ 151-152. In addition, Jarkesy was helping to promote JTF's investment banking business, another undisclosed relationsip. DFPOP ¶¶ 139-42. Finally, Respondents did not disclose the control that they had delegated to Belesis/JTF concerning Galaxy. DFPOP ¶¶ 153-55.	RX-327, Tr. 558, 657-658, 666, 688-694; Respondent's Proposed Findings of Fact ("RPFoF"), ¶¶ 151-52.	The focus of Respondents' exception appears to be that America West was never able to confirm that this relationship between Jarkesy and Belesis/JTF existed. America West, however, believed this relationship existed sufficiently to make the public disclosure. DX-346. Moreover, Alexander Walker of America West testified that he gave Jarkesy the opportunity to address what the JTF representative had told him but Jarkesy did not address it directly and said that they would just have to move on. Tr. 660-61.
27	In his testimony, Jarkesy indicated that his selection of the John Thomas name was serendipitous.	The ALJ erroneously concluded that the selection of the name for John Thomas Financial was serendipitous. Initial Decision 9. This finding mischaracterizes the evidence and ignores contradictory evidence.	Tr. 74		RX-327, p.4; Tr. 74.	This factual finding of the ALJ, even if erroneous, had no bearing on the decision and, as such, was harmless error.
28	Belesis and Jarkesy became acquainted in 2003. At the hearing Jarkesy denied that it was 2003 when he became acquainted with Belesis, but did not provide an alternate date. The reason for this is not apparent from the record.	The ALJ erroneously concluded that Belesis and Jarkesy became acquainted in 2003. ALJ further erroneously concluded in a footnote that Jarkesy denied that date but did not provide an alternate date. Initial Decision 8. This finding mischaracterizes the evidence and ignores and excluded contradictory evidence of the correct date offered by Respondents.	Tr. 2515-21		RX-327, p. 1; Tr. 74-75, 2514-2521.	Jarkey initially testified in response to questions from the Division that he did not recall when he met Belesis. Tr. 74. When questioned by his attorneys, he was asked to read into the record his investigative testimony where he had stated that he met Belesis in 2003 or 2004 in connection with the Opexa financing. Tr. 2516. This testimony is consistent with the ALJ's factual finding that Jarkesy and Belesis met in 2003. Even if the factual finding was erroneous, however, it had no bearing on the decision and, as such, was harmless error.
29	Belesis reinforced his position in the relationship through threats to stop selling interests in Jarkesy's Funds.	The ALJ erroneously concluded that Belesis reinforced his position in the relationship through threats to stop selling interests in Jarkesy's Funds. Initial Decision 10. This finding mischaracterizes the evidence and ignores contradictory evidence.	Div. Ex. 631 (Mar. 12, 2009, email from Belesis to Jarkesy: "our relationship based on your actions is slowly coming to an end"), Div. Ex. 643 (Aug. 21, 2010, email from JTF to JTCM: "Per Tommy . . . [t]here will no longer be any funds from John Thomas Financial clients into the bridge fund.").	DFPOP ¶136.	RX-327, p. 3-5; Tr. 558, 657-658, 666, 688-694, 2659-2660, 2702-2703, 2708-2709, 2760-2761; RPFoF, ¶¶ 151-52.	None of Respondents' citations concern Belesis' threats to stop selling Fund interests, which was directly established by the documents. In addition, the vast majority of the testimony cited is the not credible testimony of Jarkesy that there was no undisclosed relationship and that he did not delegate authority to Belesis and JTF.

No.	ALJ's Actual Factual Findings	Respondent's Characterization of Findings	ALJ's Citations	Citation to the Division's Proposed Findings of Fact ("DFPOP") or Other Record Support	Respondent's Citations in Support of their Proposed Exceptions	Notes
30	He [Jarkesy] generally testified in an evasive manner that did not provide any assurances of the reliability of his testimony. Thus, no weight has been placed on his testimony as to facts that are disputed or not corroborated by credible evidence elswhere in the record. In the course of his testimony, Jarkesy responded, "I don't recall" or a variant of that phrase more than 800 times, including to such questions as: "what is restricted stock?"; "what is your understanding of what institutional investors are?"; "if the fund had more than 5 percent in one company, it wouldn't be diversified?"; "[d]o you think that the addition of the term restricted makes that a different company?"; and "[d]id you have discussions with John Thomas Financial about how they were going to find investors for the fund?"	The ALJ erroneously concluded that Jarkesy testified in an evasive manner that did not provide any assurances of the reliability ofhis testimony. Initial Decision 10. These findings mischaracterize Jarkesy's testimony.	Tr. 87, 160, 122-23, 185, 1184.	Division's Post-Hearing Memorandum of Law atp. 1-2.	Tr. 2689-2690.	Respondents' citation to the record is to a comment made by the ALJ that she noticed that Jarkesy was able to answer a question asked by his own attorney but was unable to answer the same question when asked by the Division. Respondents fail to provide any citations to the record that undermine the ALJ's credibility determination regarding Jarkesy.
31	While Jarkesy evaded a large portion of the Division's questions, his recollection markedly improved when questioned by his own counsel. Jarkesy's participation in the hearing on March 7, 2014, illustrates this. For the majority of that hearing day (approximately 120 transcript pages), Jarkesy's counsel conducted direct examination of him, during which Jarkesy used the phrase "I don't recall" or something similar about twenty-five times, while otherwise providing substantive answers to his counsel's questions. When the Division cross-examined Jarkesy, however, he responded to questions. with "I don't recall" or something similar over forty times in a significantly shorter period (less than twenty transcript pages) of questioning. For example, among the Division's first questions on cross-examination was "the bridge loans, those were high risk?," to which he answered. "I don't recall all the bridge loans, how were they done. The Division's next question, "[t]he private placements, those were high risk?," was answered with "I don't recall the private placements. Jarkesy further undermined his credibility by disclaiming responsibility for representations about the Funds made in PPMs, financial statements, marketing materials, and newsletters as discussed below.	The ALJ erroneously concluded that while Jarkesy evaded a large portion of the Division's questions, his recollection markedly improved when questioned by his own counsel. Initial Decision 11. This finding mischaracterizes Jarkesy's testimony.	Tr. 2780-2818, Tr. 2658-2779.	Division's Post-Hearing Memorandum of Law at p. 1-2.	Tr. 2689-2690.	Respondents' citation to the record is to a comment made by the ALJ that she noticed that Jarkesy was able to answer a question asked by his own attorney but was unable to answer the same question when asked by the Division. Respondents fail to provide any citations to the record that undermine the ALJ's credibility determination regarding Jarkesy.

No.	ALJ's Actual Factual Findings	Respondent's Characterization of Findings	ALJ's Citations	Citation to the Division's Proposed Findings of Fact ("DFPOF") or Other Record Support	Respondent's Citations in Support of their Proposed Exceptions	Notes
32	The Funds' PPMs and marketing materials contained various representations about the Funds and JTCM/Jarkesy's plans for managing them. Some of the representations that may have been accurate when the documents were first used became inaccurate and were not corrected. Respondents argue that the Division did not prove that Fund I's June 1, 2007 PPM (as amended on August 21, 2007 ...) and Fund II's February 5, 2209. PPM were used without alteration in selling interests in the Funds throughout the time at issue. However, Respondents, who are in the best position to know of any successor PPM amendments, did not offer evidence of any changes. Accordingly, it is found that Fund I's June 1, 2007, PPM, as amended on August 21, 2007, and Fund II's February 5, 2009, PPM were used without further amendments in selling interests in the Funds during the time at issue.	The ALJ erroneously concluded that some of the representations in the marketing materials may have accurate when the documents were first used became inaccurate and were not corrected. The ALJ further erroneously states that Respondents argue that the Division did not prove that the private placement memoranda were used without alteration throughout the time at issue. However, Respondents, who are in the best position to know of any successor PPM amendments, did not offer evidence of any changes. The ALJ further erroneously found that the private placement memoranda were used without further amendments in selling interests in the Funds during the time in issue. Initial Decision 11. These erroneous findings mischaracterize the evidence-including express authority to change professionals, business plan and asset mix-and Respondents' legal obligations and the applicable burden and standard of proof.		DFPOP at ¶¶ 11-30, 43-51.	RX-1, RX-2, RX-3, RX-316, RX-321, RX-322, RX-323, RX 324, RX-325, RX-326.	Respondents' primary argument appears to be that they were authorized to change the strategy of the Funds and to change professionals. The fallacy of this argument is that through 2010, Respondents continued to represent that the strategy in the PPM was in fact the strategy employed. Respondents continually represented throughout the life of the Funds that they were investing half of the money in insurance policies and that they had purchased policies with face value of at least 117% of capital invested. *See, e.g.*, DX 260 (March 2009); DX 220 (May 2009); DX 262 (June 2009); DX-637 (July 2009); DX 221 (March 2010); DX 259 (June 2010); DX 248 (August 2010). During the podcast, Respondents emphatically reiterated the 117% coverage requirement: "Our charter required that we have 117 percent of the value of our investor cash in face value life settlement policies. We do this not to make money. We do it, because at the end of the Fund, we want our investors to have some assurance that they get their money back." DX-203 at 3. Likewise, Respondents repeated that they were limited to a 5% investment in a single company. DX-214; DX-215; DX-216; DX-217; DX-258.
33	Investors might be able to redeem their investments, but upon potential payment of a penalty. Jarkesy withdrew from Fund I $100,000 less a $20,000 penalty during February 2009.	The ALJ erroneously concluded that investors might be able to redeem their investments, but upon potential payment of a penalty. Initial Decision.Initial Decision 12. This conclusion mischaracterizes the evidence, the written terms of the investment, relies on unreliable evidence and ignores contradictory evidence.	Div. Ex. 206 at 20 ("you will not be able to withdraw your investment from [Fund I] without significant penalty, if at all. See Liquidity Risks.") 28; Div. Ex. 210 at 28 ("During [the lock-up period], Limited Partners may not be able to make any withdrawals from their Capital Accounts. See 'Risk Factors -- Risks related to illiquidity'"). Tr. 1330-35; Div. Ex. 236at 17 Div. Ex. 316at 11. Div. Ex. 659	DFPOP ¶65.	RX-1, p. 16-54, RX-2, p. ii-iii, 12-35; RX-3.	Not only does the PPM provide that there might potentially be a penalty if an investor tried to take money out of the Fund, but Jarkesy, himself, paid a penalty when he withdrew $100,000 from Fund I. Even if this factual finding was erroneous, it is a harmless error as it had no impact on the legal conclusions that Respondents violated the securities laws.
34	Investor Robert Fullhardt believed that the Fund had a September 2012 maturity date. Investor Steve Benkovsky also believed that the fund had a five-year duration that would end in 2012.	The ALJ erroneously concluded that investor Robert Fullhardt believed that the Fund has a September 2012 maturity date, and investor Steve Benkovsky also believed that the fund had a five-year duration that would end in 2012. Initial Decision 12. These findings mischaracterize the evidence-including the written terms of the investment-rely on unreliable evidence and ignore contradictory evidence.	Tr. 710, 746, 1362.	DFPOP ¶¶160-161.	RX-1, DX-206 (PPM specifies Fund I as a 10-year fund with the option to extend the fund by two one-year extensions at Respondents' option); Tr. 2513-2514; RPFoF, ¶ 160.	Jarkesy repeatedly told investors that Fund I was designed to wind up by September 2012. DFPOP ¶¶ 160-161. These representations provided a sufficient basis for the investors to believe that the fund would terminate in September 2012. Indeed, in his investigative testimony, Jarkesy testified that the Fund would shut down and go into liquidiation in September 2012. DX-122 at 71:1-72:6.

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35	In a podcast sent to investors on May 21, 2009 (Podcast), Jarkesy explained that 50% of capital invested would go into life settlements; of that 50%, 30% would be used to buy the policies, and the remaining 70% would be "set aside to pay premiums through the life expectancy."	The ALJ erroneously concluded that in a podcast sent to investors on May 21, 2009, Jarkesy explained that uses of investment capital by percentages. Initial Decision 13. This conclusion mischaracterizes the evidence, relies on unreliable evidence, ignores contradictory evidence and misapplies the law.	Div. Ex. 203 at 21-22, Div. Ex. 204	DFPOP ¶ 19.	RX-1, DX-206, at cover iii, 15-27; RPFoF, ¶ 9.	The podcast transcript, stipulated as to accuracy to by counsel for Respondents, Tr. 210, is clear on its face. The transcript was sent to the investors. DX-204.
36	The PPM for each Fund stated that the Fund would make two types of investments: (1) investments in in-force life insurance policies with face values totaling 117% of the aggregate capital commitments and (2) short to medium term debt and equity investments in business enterprises. . . . The PPMs described JTCM's plans to invest in a "Life Settlement Portfolio" and a "Corporate Portfolio." Life settlement refers to the purchase of existing life insurance policies at a discount to their face values, maintaining them by paying the premiums, and collecting when the insured dies. The corporate portfolio was to contain various forms of debt and equity in companies.	The ALJ erroneously concluded that remaining portion of funds after life insurance policies were bought was to go to medium term debt and equity in business enterprises. Initial Decision 13. These findings mischaracterize the evidence-including express authority to change business plan and asset mix-relies on unreliable evidence and ignore material other evidence.	Div. Ex. 206 at 7, 33-39, Div. Ex. 210 at 12, 55-62.	DFPOP ¶¶11-12, 18	RX-1, DX-206, at 3-4, 7, 30, 33; RPFoF, ¶ 18	Respondents do not contest that the PPMs for the Funds explained how the money would be invested. Instead, they argue that the PPMs gave Respondents the authority to change business plans and investment strategies. The problem with this argument is that, as stated above, Respondents in marketing materials continued to represent that this would be how the Funds would be invested. And the Funds continued to be sold pursuant to the PPMs, which described the investment strategy.
37	The PPM for Fund II did not provide such numerical details. However, marketing materials for Fund II represented that about half of Fund II's investment would be in insurance policies amounting to at least 117% of capital commitments with additional funds to secure payment of premiums, with the other half in corporate investments.	The ALJ erroneously concluded that the PPM for Fund II did not provide such numerical details. However, marketing materials for Fund II represented that about half of Fund II's investment would be in insurance policies amounting to at least 117% of capital commitments with additional funds to secure payment of premiums with the other half in corporate investments. Initial Decision 14. These findings mischaracterize the evidence, the written terms of the investment, rely on unreliable evidence and ignore contradictory evidence.	Div. Exs. 224, 608.		RX-1, p. 16-54; RX-2, p. ii-iii, 12-35; RX-3; Tr. 231-235, 350, 954-955.	Respondents' citation to RX-2 and RX-3, which are documents for Fund I, is curious because the contested finding concerns Fund II and not Fund I. The ALJ's factual finding was correct. The PPM for Fund I specifically stated that the Fund would purchase life insurance policies with a face value of 117% of the invested amount. DX-206 at 39. In contrast, while the PPM for Fund II stated that the Fund would invest in life insurance policies, the PPM did not provide the 117% number. DX 210 at 47-48. The 117% number for Fund II only appears in marketing materials. Similarly, the PPM for Fund I stated that approximately 40% of money invested would go into corporate investments. DX-206 at 33. The PPM for Fund II, while describing the corporate portfolio, did not provide this percentage. DX 210 at 51-52. Respondents' citations to the transcript do not contradict the ALJ's findings in any way.
38	Contrary to the representations in the Funds' PPMs and financial statements that JTCM set the valuations for the Funds' positions, Jarkesy disclaimed responsibility for this, indicating that AlphaMetrix valued the Funds' positions. Questions concerning valuation were directed to Jarkesy or to his assistants Linda Ortiz and Patty Villa, who relayed Jarkesy's decisions.	The ALJ erroneously concluded that contrary to the representations in the Funds' PPMs and financial statements that JTCM set the valuations for the Funds' positions, Jarkesy disclaimed responsibility for this, indicating that AlphaMetrix valued the Funds' positions. The ALJ made additional erroneous conclusions regarding who participated in valuing assets and how assets were valued. Initial Decision 15. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Tr. 2663 ("The valuations were provided and checked by Alpha[M]etrix."); see also Tr. 1144 (The auditors "considered AlphaMetrix part of the management team."), 2157 (Jarkesy describing AlphaMetrix as a valuation consultant). Tr. 295, 300-06, 428; Div. Exs. 329, 330, 333.		Ex. DX-230; Tr. 286, 288-290, 409-415, 420-422, 2396, 2662-2664; RPFoF, ¶ 57.	The testimony cited by Respondents does not counter the ALJ's finding that Jarkesy disclaimed his role in the valuation process. Indeed, in their response to the Division's proposed findings of fact, Respondents continue to assert that the administrator "influenced the manner in which certain positions were valued where no outside validation existed."

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39	Investor updates and other marketing materials created by Jarkesy and JTCM between 2008 and 2010 identified KPMG LLP (KPMG), among others, as the auditor of Fund I, and other marketing materials identified KPMG as the auditor for both Funds through 2010. However, KPMG never audited either Fund. . . . . Jarkesy and JTCM's marketing materials for the Funds identified Deutsche Bank, among others, as the Funds' prime broker. However, Deutsche Bank never became the Funds' prime broker.	The ALJ made erroneous conclusions regarding the role of KPMG and Deutsche Bank and the representations about them to investors. Initial Decision 15. These findings mischaracterize the evidence-including express authority to change professionals and the business plan-rely on unreliable evidence and ignore material other evidence.	Answer at ¶ 6. Div. Exs. 220-224, 229A, 248, Tr. p. 565.	DFPOF ¶¶27-29.	Answer, ¶¶ 4, 59-61; RX-316; RX-327, p. 4; Tr. 2669-2672, 2677-2688, 2759-2760; RFPoF, ¶ 57.	Respondents admitted in their answer that KPMG was never enaged to audit Fund I and, in fact, did not audit Fund I. Consequently, any marketing material that said that KPMG was the auditor for Fund I was blatantly false. KPMG was also never engaged to audit Fund II and never audited Fund II, although KPMG may have been engaged to audit a Fund structure that was ultimately scrapped. As such, any marketing material that identified KPMG as the auditor for Fund II was also false. There is no evidence that Deutsche Bank was the prime broker for either of the Funds.
40	The Funds' PPMs and marketing materials contained various representations about the Funds and JTCM/Jarkesy's plan for managing them. Some of the representations that may have been accurate when the documents were first used became inaccurate and not corrected.	The ALJ erroneously concluded that some statements in the PPM may have been accurate when made, became inaccurate and remained uncorrected. Initial Decision 11. These findings mischaracterize the evidence-including express authority to change professionals and the business plan-and mischaracterize the law and duties applicable to Respondents.		See Response to Exception 32 above.	RX-1, RX-2, RX-3, RX-316, RX-324, RX-325.	Respondents in this case did not produce any amendments to the PPMs outside of DX-208, which did not concern any of the representations at issue in the hearing. Fund interests continued to be sold through at least 2010. Even if the statements in the PPMs were accurate when initially made, during later periods of time, those statements were false. Respondents were not complying with the 5% investment limitation or the 117% insurance converage requirement. Yet Respondents continued to sell Fund interests pursuant to those PPMs, which they knew did not accurate describe what was happening. The marketing materials contained many of those same representations.
41	The Funds' financial statements represented that the assets were fair valued pursuant to Financial Accounting Standards Board Statement of Financial Accounting Standards No. 157 (FAS 157), effective January 1, 2008.	The ALJ erroneously concluded that Financial Statements represented valued according to FAS 157. Initial Decision 14. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Div. Ex. 315 at 9, Div. Ex. 316 at 9, Div. Ex. 317 at JTBOF 6296, Div. Ex. 318 at JTBOF 6308	DFPOF at ¶¶ 52-56.	RPFoF, ¶ 55.	In Paragraph 55 of their proposed findings of fact, Respondents concede that the notes to the financial statements explicitly provided that they were going to be prepared according to FAS 157. This is exactly the ALJ's finding so it is unclear on what basis Respondents are challenging the ALJ's finding.
42	The valuation of each asset in the Funds' holdings at each month-end was shown on each Funds' holding pages. Each individual investor's share was calculated from the aggregate valuation shown on the holdings pages.	The ALJ erroneously concluded that valuation of each asset in the Funds' holdings was listed on each Funds' holdings pages, and that each investor's share was calculated from those holding pages. Initial Decision 14-15. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Tr. 326-28, 402-03; Div. Exs. 301, 303.	DFPOF at ¶¶ 57-59.	Tr. 175-180, 1199.	In his testimony, Troy Golinghorst from the Fund administrator identified DX 301 as the holdings pages for Fund I for various points in time, and he explained how this information made its way into each individual investor's account statements. Tr. 326-28. The testimony cited by Respondents in support of their proposed exceptions is Jarkesy denying any knowledge of these documents (notwithstanding that they had been produced by Respondents in the investigation). This is another example of Jarkesy's unreliable and unbelievable testimony.

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43	In reality, AlphaMetrix did not value any of the Funds' positions itself; it had no capability to do so. AlphaMetrix attempted to obtain valuations for the Funds' positions from independent sources, such as Bloomberg; for assets, such as the Funds' bridge loans and short-term notes, life settlement policies, and warrants, for which it could not obtain values from an independent data provider, it asked JTCM for valuations. AlphaMetrix tried to get as much documentation as possible in support of JTCM's marks. AlphaMetrix tried to get as much documentation as possible in support of JTCM's marks.	The ALJ erroneously concluded that Alphametrix did not participate in valuing the funds. Initial Decision 14. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence	Tr. 287-300, 311-12.	DFPOP at ¶¶ 57, 92-93, 129.	DX-230; Tr. 286, 288-290, 409-415, 420-422, 2396, 2662-2664; RPFoF, ¶ 57.	Troy Golinghorst's testimony on this issue is clear. In addition, the documents demonstrate that the administrator sought and received values from Respondents. *E.g.*, DX-333, 662, 665.
44	Questions concerning valuation were directed to Jarkesy or to his assistants, Linda Ortiz and Patty Villa, who relayed Jarkesy's decisions. Jarkesy had the final word, even if unreasonable, in setting valuations; for example, he insisted on valuing restricted America West stock at the same price as free-trading stock even after AlphaMetrix questioned this.	The ALJ erroneously concluded that any question concerning valuation would go to Jarkesy (through subordinates at times) and Jarkesy had the final word setting valuations, even if unreasonable. Initial Decision 15. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Tr. 295, 300-06, 347-50, 428.	DFPOP at ¶¶ 57-58, 129.	Tr. 288, 294-295, 297-299, 306, 308-309, 311-312, 316-318; RPFoF, ¶ 58.	Troy Golinghorst's testimony on this issue is clear. In addition, the documents demonstrate that the administrator sought and received values from Respondents. *E.g.*, DX-333, 662, 665.
45	JTCM would approve the holdings, then approve any profit and loss, then approve financial statements, and ultimately the investor statements.	The ALJ erroneously concluded that JTCM approved all statements - holdings, profit and loss, financial statements, and investor statements. Initial Decision 15. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Tr. 328.	DFPOP at ¶¶ 57-59.	RX-19; RX-20; RX-21; RX-22; RX-300; RX-301; Tr. 328; 409-415, 420-422; RPFoF, ¶ 59.	Troy Golinghorst's testimony on this issue is clear. In addition, the documents demonstrate that the administrator sought and received values from Respondents. *E.g.*, DX-333, 662, 665.
46	After an appeal from then CEO Frank DelVecchio on December 17, 2009, Belesis ordered Jarkesy to provide funds "ASAP." The next day, December 18, 2009, Fund I bought $30,000, and Fund II, $10,000, of Galaxy stock.	The ALJ erroneously concluded that on December 12, 2009 Belesis ordered Jarkesy to deliver funds and on December 18 Fund I bought $30,000 in Galaxy stock and Fund II bought $10,000 in Galaxy stock. Initial Decision 17. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Div. Exs. 513, 314 at 15.	DFPOP at ¶¶ 153-155.	Tr. 2449-2450, 2697-2702, 2760, 2762; RPFoF, ¶ 154.	As the documents demonstrate, on December 17 at 3:25 pm, Belesis told Jarkesy: "George, get frank the bridge ASAP." DX-513. Galaxy's public filings demonstrate that the very next day, the Funds bought $40,000 worth of shares of Galaxy in a private placement. DX-314 at 15. The DFPOP describes other examples of Belesis ordering Jarkesy to do something and it got done. Jarkesy's testimony to the contrary, that he only did what was in the Funds' interests, was held by the ALJ to be unreliable and not credible.

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47	Fund II did not buy any life insurance policies; neither its financial statements nor holdings pages show any indication that Fund II owned policies. This was inconsistent with the representations in Fund II's PPM and marketing materials.	The ALJ erroneously concluded that inconsistent with the PPM, Fund II bought no life insurance policies. Initial Decision 22. These findings mischaracterize the evidence, rely on unreliable evidence and ignorematerial other evidence.	Div. Exs. 303, 318, 210 at 12, 55-60, 224.	DFPOP at ¶¶ 37-39.	RX-1, RX-2, RX-3, RX-318.	There is no evidence that Fund II ever bought a single insurance policy. It appears, however, that Fund II purchased interests in the insurance policies that Fund I had purchased. Respondents, however, did not comply with their obligation to purchase 117% insurance coverage for Fund II as described in the marketing materials. As such, while the ALJ's factual finding might technically have been wrong, Respondents still did not comply with their obligations and, as such, the error is harmless.
48	Between September 28. 2007 and January 25, 2008 Fund I purchased eight life insurance policies with face values ... totalling $13.5 million. As of December 31. 2008. Fund I had capital contributions of $16,620,511. Div. Ex. 315 at 11. Thus, the $13 million total face valueof the policies was less than the 117% of that sum as promised in the PPM and marketing materials	The ALJ erroneously concluded that Fund I did not meet 117% obligation in 2008. Initial Decision 22.This finding mischaracterizes the evidence-including express authority to change business plan and asset mix-relies on unreliable evidence and ignore material other evidence.	Div. Exs. 405, 315 at 11.	DFPOP at ¶¶ 37-39.	RX-1; DX-206.	Respondents fail to explain how their citation to the PPMs for Fund I demonstrate that the ALJ's factual finding was false. To the extent that they are suggesting that they had the ability to change strategy and did not need to comply with this requirement, the Division refers the Commission to its response above demonstrating that Respondents continually represented that they would meet the 117% requirement.
49	In April and May 2009. Fund I bought five additional policies, with face values totalling $13.5 million. Respondents decided to allow one policy (Paul Evert) with a face value of $5 million to lapse during 2009. . . . The $21.5 million face value was less than 117% of capital contributions, $20,112,852, as of December 31, 2010. Div. Ex. 317 at 11.	The ALJ erroneously concluded that Fund I did not meet 117% obligation in 2010. Initial Decision 23. This finding mischaracterizes the evidence-including express authority to change business plan and asset mix-relies on unreliable evidence and ignoresmaterial other evidence.	Div. Exs 405, 317 at 11.	DFPOP at ¶¶ 37-39.	DX-206 at cover-iii, 15-27, 33; DX-405 (Funds owned policies with face value of $24.5 million, which meant that Respondents did not misrepresent that they had 117% face value); Tr. 2386-2388, 2398-2399; RPFoF, ¶ 43	By the end of 2009, the Funds owned policies with a combined face value of $21.5 million -- because Respondents allowed the Evert policy to lapse in mid-2009 and cannot be included in the total. It is unclear how Respondents arrive at the $24.5 million number. With total investor capital of approximately $19.158 million by year end, Respondents were required to purchase insurance policies with a combined face value of more than $22.4 million. They were short by approximately $1 million. Moreover, from that point until this date, Respondents did not comply with the 117% requirement. To the extent that Respondents are arguing that they could change strategy, see above.
50	Further, Respondents spent only $3,865,309 (including paying premiums) on life insurance policies through December 31, 2010. This fact, together with the fact that Respondents did not set aside funds sufficient to pay premiums shows that Respondents did not invest in insurance policies as promised in the PPM and marketing materials. Nor did they timely put all policies in the Master Trust.	The ALJ erroneously concluded that Respondents did not spend the amount pledged on insurance policies/premiums; nor put the policies in the master trust in a timely fashion as promised in the PPM and marketing materials. Initial Decision 23. These findings mischaracterize the evidence-including express authority to change business plan and asset mix-rely on unreliable evidence and ignore material other evidence.	Div. Exs. Div. Ex. 317 at 10, 401, 402, 405	DFPOP at ¶ 40.	Tr. 1504-1524	The testimony cited by Respondents in support of their exception is Jarkesy's testimony that he does not recall how much money he spent on the policies and premiums. This testimony does not undermine the ALJ's findings, which were based on the financial statements provided by the Funds to the investors.

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51	Respondents subsequently used different actuaries to value the five policies purchased in 2009, again requesting a 12% discount rate. Yet at the same time, Jarkesy knew he was currently purchasing policies at a 15% or better (that is, more inexpensively than 12%) discount. Respondents continued using the 12% discount rate for Fund I's 2010 financial statements.	The ALJ erroneously concluded that Respondent purchased policies at 15% rate, but valued at 12% rate. Initial Decision 24. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Div. Exs. 432, 433, 436, 440, 442, 203 at 23, 204, 619 at 1, 623.	DFPOP ¶¶ 66-72.	DX-425; DX-621; Tr. 504-505, 2405-2406, 2662-2264; RPFoF, ¶¶ 68-69, 71.	DX-425 concerns policies purchased in 2007 and is irrelevant to the ALJ's finding concerning the 5 policies purchased in 2009. DX-621, in fact, demonstrates that Respondents were looking to purchase policies at a 15% discount rate, which supports the ALJ's findings. The testimony of Steve Boger does not concern the valuation of the policies bought in 2009. Tr. 504-505. Boger was not involved in those purchases. The remainder of the testimony is Jarkesy's and it does not address the issue decided by the ALJ.
52	Pursuant to Financial Accounting Standards Board (FASB) Staff Position 85-4-1, investors who use fair value must initially value a life insurance policy at the purchase price and remeasure it at fair value at each subsequent reporting period. However, Respondents immediately fair valued the new policies. Thus, as compared with the total purchase price of $1,195,000, the five policies (purchased between April 7 and May 1) were valued at $2,307,567 as of May 31, 2009, a write-up of $1,112,567.	The ALJ erroneously concluded that Respondent immediately wrote up the value of policies in contravention of FASB Staff Position 85-4-1. Initial Decision 24. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Div. Exs. 119 at 2, 498B at AM_SEC 285200 (lines 379-93), 285203 (lines 491-92), Div. Ex. 647.	DFPOP at ¶60.	Record devoid of expert testimony on this issue; see I supra.	The requirements of FASB Staff Position 85-4-1 could not be more clear. "Under the fair value method, an investor shall recognize the initial method at the transaction price. In subsequent periods, the investor shall remeasure the investment at fair value in its entirety and each reporting period." (DX-ld9 at 2). No expert testimony was necessary. Moreover, it is clear that Jarkesy understood this requirement as the policies purchased in 2007 were initially valued at the transaction price and only "fair valued at the end of the reporting period."
53	Jarkesy's August 2010 letter to investors stated that "we are adding more policies to the portfolio," which was untrue since Fund I purchased no policies after 2009.	The ALJ erroneously concluded that Jarkesy represented to investors that Fund I continued to purchase insurance policies in an August 2010 letter to investors which was a misrepresentation because Fund I never acquired a policy after 2009 year end. Initial Decision 24. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Div. Ex. 240.	DFPOP ¶ 158.	Tr. 2501-03.	Jarkesy's testimony says nothing about purchasing insurance policies after 2009 but instead concerns whether Respondents were able to sell certain policies. As such, this testimony does not in any way support Respondents' claimed exception.
54	Although representing the insurance component as a conservative hedge, Respondents took no steps to reduce risk. Investing in a large number of policies reduces risk, known as mortality risk, as Jarkesy knew and Fund I's PPM represented; if there are only a few policies, the insureds might all live much longer than actuarially expected, thus postponing the payout and extending the time during which premiums must be paid. Yet Respondents only acquired thirteen policies.	The ALJ erroneously concluded that Respondents represented the insurance policies as a conservative hedge but took no steps to reduce risk. Did not invest in a large number of policies as required to reduce risk. Initial Decision 24. These findings mischaracterize the evidence-including express authority to change business plan and asset mix-rely on unreliable evidence and ignore material other evidence.	Tr. 465-66; Div. Ex. 206 at 36-37, Div. Ex. 600.	DFPOP ¶¶ 13-15, 39	RX-1; DX-206 at cover-iii, 15-27, 33; RPFoF, ¶ 14.d	Respondents are in error. The PPM's disclosure of mortality risk do not excuse Respondents from failing to take any steps to mitigate the risk, asd they explicitly promised they would do. Nor would such disclosure allow Respondents to continue making false representations that the insurance policies were less risky investments and a hedge to the more risky elements of the portfolio, which was misleading because they had failed to take any steps to mitigate mortality risk.

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55	Respondents argue that the representations were not false when made and that the PPM gave JTCM discretion to change the investment strategy of the Fund. Yet, Respondents never informed investors and potential investors of such changes. The marketing materials and newsletters even continued to stress that the insurance portfolio was a conservative hedge against the corporate portfolio and continued to stress the 5% limitation.	The ALJ erroneously concluded that Respondents never told investors and potential investors that the strategy from the PPM changed. Initial Decision 28. These findings mischaracterize the evidence including express authority to change business planand asset mix-rely on unreliable evidence, ignore material other evidence, and mischaracterize the law and duties applicable to Respondents.		DFPOP ¶¶ 19-26, Division's Post-Hearing Reply Memorandum of Law at pp. 24-26.	RX-1, p. 16-54, RX- 2, p. ii-iii, 12-35; RX-3.	See above concerning Respondents' argument that they PPMs gave them the ability to change strategy.
56	Nor did they advise their auditors that any of the notes were impaired.	The ALJ erroneously concluded that Respondents did not advise auditors of impairment of the notes. Initial Decision 17. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Tr. 1047-48, 1159.	DFPOP ¶ 107.	Tr. 2748- 2750; RPFoF, ¶ 102	Jarkesy's testimony says nothing about whether he advised the auditors that the notes were impaired.
57	Jarkesy spoke highly of America West in the Podcast. His optimism was inconsistent with America West's true financial condition: the unaudited financial statements included with America West's Form 10-Q for the quarter ended March 31, 2009, contained a going concern statement.	The ALJ erroneously concluded that Jarkesy spoke highly of Am. West in a podcast that did not reflect the true condition of America West. Initial Decision 17. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 208-10; Div. Ex. 203 at 13-14, 16-17, Div. Ex. 204. Div. Ex. 348 at 11		Tr. 2409-2413, 2426-2430, 2725-2731, 2748-2479.	The only evidence that Respondents provide in support of this exception is Jarkesy's self-serving testimony, which the ALJ held was not credible or reliable. Even if Jarkesy subjectively believed that America West was going to be a succesful company, his statements were misleading because he did not inform the investors of the objective facts: that the auditors had issued a going concern opinion and that America West was in default on the loans the Funds had made to it.
58	Jarkesy also had an optimistic "Research Report" concerning America West sent to Fund investors in September 2010, and a press release concerning an interview with Jarkesy about America West.	The ALJ erroneously concluded that Jarkesy sent an optimistic "Research Report" to investors in September 2010 and issued a press release regarding America West that did not reflect true financial condition of the company. Initial Decision 17. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence.	Tr. 339-41; Div. Exs. 239, 250.	DFPOP ¶¶ 113-114.	Tr. 2409-2413, 2426-2430, 2725-2731, 2748-2479.	The only evidence that Respondents provide in support of this exception is Jarkesy's self-serving testimony, which the ALJ held was not credible or reliable. Even if Jarkesy subjectively believed that America West was going to be a succesful company, his statements were misleading because he did not inform the investors of the objective facts: that the auditors had issued a going concern opinion and that America West was in default on the loans the Funds had made to it.
59	AlphaMetrix relied on Jarkesy's valuations since Galaxy was not publicly traded.	The ALJ erroneously concluded that Alphametrix relied on Jarkesy for valuation of Galaxy because it was not publicly traded. Initial Decision 18. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 308-09; Div. Exs. 324, 329, 330.	DFPOP ¶¶ 57-58, 93	Tr. 2706-2708; RPFoF, ¶¶ 83, 89, 93.	See notes to exception 43. In addition, Jarkesy's testimony cited here (which is neither credible nor reliable), does not concern Galaxy specifically.

No.	ALJ's Actual Factual Findings	Respondent's Characterization of Findings	ALJ's Citations	Citation to the Division's Proposed Findings of Fact ("DFPOP") or Other Record Support	Respondent's Citations in Support of their Proposed Exceptions	Notes
60	From the end of 2009 through the beginning of 2011, the value that Respondents assigned to Galaxy and its predecessor company varied widely from $0.10 to $3.30.	The ALJ erroneously concluded that from 2009 - 2011 Jarkesy valued shares wildly. Initial Decision 18. This finding mischaracterizes the evidence including material corporate events affecting pricerelies on unreliable evidence and ignores material other evidence.	Div. Exs. 301, 305.	DFPOP ¶ 90.	Tr. 2468, 2706-2708, 2735-2739; RPFoF, ¶¶ 83, 89-90.	Much of the testimony cited by Respondents does not concern the valuation of Galaxy from 2009 through early 2011. The testimony at Tr. 2735-39 concerns a valuation report for Galaxy that Respondents obtained in June 2011 and, as such, could not have been relied upon by Respondents during the time period in question for the valuations. This report, which was unreliable, is discussed in detail in the DFPOP ¶¶ 95-97. Notably, the author of the report was listed on Respondents witness list, but Respondents declined to call him as a witness. To the extent that any of the cited testimony of Jarkesy concerns the valuation of Galaxy during this time period, that testimony was unreliable and not credible.
61	The number of shares outstanding during that time varied, due to a reverse split, issuance of penalty/liquidated damages shares, etc.; however, the changes in the valuations did not accord with these events.	The ALJ erroneously concluded that changes in price did not coordinate with events occurring inside Galaxy. Initial Decision 18. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 307-25, 2468, 2733-35	DFPOP ¶¶ 90-91.	Tr. 2706-2708, 2735-2739; RPFoF, ¶¶ 83, 89-90.	The chart contained in the DFPOP at ¶ 90 and explained in ¶ 91 demonstrates that the changes in Respondents' valuation of Galaxy did not match up with the dates of the reverse splits and share issuances.
62	Together, Belesis and Jarkesy exerted control over the company [Galaxy].	The ALJ erroneously concluded that together Jarkesy and Belesis exerted control over Galaxy. Initial Decision 18. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 1555-56, 1567-69, 1572-86, 1711.	DFPOP ¶¶ 153-55.	Tr. 558, 2449-2450, 2697-2702, 2760, 2762; RPFoF, ¶¶ 153-154.	Besides Jarkesy's own testimony, the only so-called evidence that Respondents cite in support of this exception is the testimony of Jarkesy's assistant, Patty Villa, that Jarkesy made all of the invetsment decisions. Tr. 558. At the same time, however, Villa testified she never spoke with Belesis about anything substantive, Tr. 598, and that she couldn't hear Jarkesy's phone conversations and had no idea what Jarkesy might have spoke about with various entities. Tr. 603-05. Consequently, Villa's testimony on who made the investment decisions for the Funds is of limited probative value.

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63	There were no public transactions in the stock [of Radiant] during July, August, or September 2010. Respondents sold 300,000 shares of Radiant from Fund I to Fund II in August, with a cost basis to Fund II of $0.23. Nonetheless, Respondents increased their valuation of Radiant in Fund I to $1.00 per share in August 2010, causing an increase in Fund I's unrealized profits for this holding.	The ALJ erroneously concluded that Fund I sold 300,000 shares of Radiant to Fund II in Aug. 2010 with a cost of $0.23 per share. Respondents increased the valuation of those shares the same month to $1.00 per share causing Fund I's unrealized profits to rise.Initial Decision 19. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence	Div. Exs. 111; 303 at JTBOF 19295; 301 at JTBOF 19142.	DFPOP ¶¶ 122-123, 125.	Tr. 2586-2587, 2662-2264; RPFoF, ¶¶ 123-125.	Jarkesy's testimony at 2586-2587 does not concern the August transaction in Radiant stock between Fund I and Fund II. His testimony at 2662-2664 is simply his self-serving statement that Respondents did not record arbitrary vaulations, used their best efforts, and that the valuations were checked by the administrator. This testimony again does not specifically concern the August transaction and is also unreliable and not credible. In their RFPoP, Respondents suggest that the increase in price to $1.00 resulted from a 5:1 reverse split. That 5:1 split took place in April 2010, however, and was the basis for Respoindents increasing their valuation of Radiant stock from $0.06 to $0.30. (DFPOP ¶ 121). Indeed, a 5:1 reverse split would not result in a change in valuation from $0.30 to $1.00. In sum, Respondents have not provided any basis for increasing the value to $1.00 in August or for their valuing the shares at $0.23 and $1.00 at the same time.
64	The stock traded for the first time in fifteen months during four days in December 2010, ending the year at $4 per share. The price spike was coincident with the promotional campaign discussed *infra*. Using the $4 price, Respondents' valuation of Fund I's Radiant position reflected an unrealized gain at year-end of nearly $7 million, more than a $5 million gain from the previous month.	The ALJ erroneously concluded that in December 2010 Radiant stock traded for the first time in 15 months at $4.00 per share coinciding with a marketing campaign. Initial Decision 19. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Div. Ex. 111 at 4. Div. Ex. 301 at JTBOF 19130, 19133.	DFPOP ¶¶ 126-128.	Tr. 2583-2586, 2662-2264, 2740-2742; RPFoF, ¶¶ 126-128.	Respondents do not contest any of the share price or volume information concerning Radiant RFPoF ¶ 126. Instead, they dispute the cause of the spike in the share price, stating that it was the result of a round of financing that was done in the last quarter of 2010. Radiant's filing, which actually disclosed this financing, was on November 17, 2010. RX-308. The stock price did not move at all for another month, however, until December 17, 2010. DX-111. Consequently, it is much more likely that the spike in the stock price resulted from the December promotion as opposed to the November financing, which was old news by that point in time.
65	Fund II held Radiant warrants, and AlphaMetrix relied on Jarkesy's valuations of them since they were not publicly traded. He [Jarkesy] insisted on valuing them at $6.92 as of January 31, 2011, even though they had last been priced at $0.12 on August 31, 2010.	The ALJ erroneously concluded that Jarkesy valued certain warrants in Radiant at $6.92 though they were previously valued at $0.12 four months earlier. Initial Decision 19. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Div. Ex. 333, Tr. at 302-06.	DFPOP ¶ 129.	RPFoF, ¶ 129.	Respondents do not contest that it was Jarkesy who valued the warrants at $6.92. Nor do Respondents contest that Alphametrix relied on Jarkesy's valuation or that the last time that the warrants had previously been valued at $0.12. (RPFoF ¶ 129). No explanation has ever been provided for the $6.92 value, which was even higher than the stock price on that same date ($4.00).

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66	Jarkesy stated that these Radiant shares were valued at $2 per share and opined that tho stock could be worth substantially more. Yet, the closing price available from Yahoo! Finance was $1.04 from at least October 24, 2013, to January 2, 2014; there were no transactions during that period.	The ALJ erroneously concluded that Jarkesy sent stock certificates of Radiant to certain fund investors on October 23, 2014 with a letter stating the Radiant shares were valued at least $2.00 per share. The closing price on Yahoo! Was $1.04 on Yahoo! Finance with no activity from October 24, 2013 through January 2, 2014. Initial Decision 20. These findings mischaracterize the evidence, rely on unreliable evidence and ignore material other evidence; there were no transactions during that period.	Div. Ex. 247. Div. Ex. 111A.		RX-310.	In support of their exception, Respondents cite to a Form 8-K/A for Radiant dated October 14, 2010. Respondents do not explain how this four-year-old filing contradicts the ALJ's factual finding that Jarkesy stated that the shares were worth $2 and could be worth more when the closing price of the stock at that time was $1.04.
67	Jarkesy directed America West to hire promotional firms to promote its stock and chose the firms. The price of America West spiked: it closed at $0.075 on October 1, 2010, but at $1.95 on December 31, 2010. Respondents valued America West stock at $1.95 on Fund I's holdings page as of December 31, 2010.	The ALJ erroneously concluded that Jarkesy initiated a promotional campaign in the fourth quarter of 2010 for America West stock. This caused the stock price to go up to $1.95 per share in December 2010. Subsequently on the financial statements, Jarkesy valued the stock at $1.95 per share. Initial Decision 20. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 628-32, 667-68; Div. Exs. 110, 301 at JTBOF 19130.	DFPOP ¶¶ 115-118.	Tr. 2740-2742, 2746-2747; RPFoF, ¶¶ 108, 111, 115-116,	The stock price of America West on the relevant dates is uncontested. It is also uncontested that Respondents valued tho share price of America West at $1.95 at the end of 2010. It is further uncontested that America West hired several promotional firms to promote the stock. Instead, what appears to be contested is Jarkesy's role in the promotions. Alexander Walker of America West testified that "[i]t was Mr. Jarkesy's [idea to hire these PR and promotional firms]. We relied heavily on Mr. Jarkesy's experience in this area. He spearheaded our efforts in that regard." Tr. 629-30. While the Division believes that it was reasonable to conclude that the spike in the price of America West stock was caused by the promotion, the ALJ did not specifically hold that that was the case. The initial decision does not state that the promotion "caused the stock price to go up," as Respondents characterize her finding.
68	MEC also conducted a more limited promotion of Radiant for which it was paid $5,000 by Fund II on December 28, 2010. Radiant stock, which had not traded since September 10, 2009, when it closed at $0.12, closed at $4 on December 17, 2010, and at $4 on December 31, 2010. Respondents used $4 for their valuation of Fund I's Radiant position, which reflected an unrealized 2010 year-end gain of over $6.5 million, a more than $5 million gain from the previous month.	The ALJ erroneously concluded that Jarkesy initiated a promotional campaign for Radiant as well resulting in the share price going up to $4.00 per share in December 2010, resulting in very largo gains reported on the year-end financial statements of tho Funds. Initial Decision 20. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Tr. 897-98; Div. Exs. 306c, 111, 301 at JTBOF 19130, 19133.	DFPOP ¶ 127.	Tr. 2583-2586, 2740-2742; RPFoF, ¶ 127.	Respondents do not contest any of the share price or volume information concerning Radiant. RPPoF ¶ 126. Instead, they dispute the cause of the spike in the share price, stating that it was the result of a round of financing that was done in the last quarter of 2010. Radiant's filing, which disclosed this financing, was on November 17, 2010. RX-308. The stock price did not move at all for another month, however, until December 17, 2010. DX-111. Consequently, it is much more likely that the spike in the stock price resulted from the December promotion as opposed to the November financing, which was old news by that point in time.

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69	Fund I's PPM provided, under the heading "Investment Limitations," "The total investment of [Fund I] in any one company at any one time will not exceed 5% of the aggregate Capital Commitments."	The ALJ erroneously concluded that Fund I capped the aggregate capital commitments in any 1 company at 5%. Initial Decision 21. This finding mischaracterizes the evidence, relies on unreliableevidence and ignores material other evidence.	Div. Ex. 206 at 12.	DFPOP ¶ 18.	Ex. DX-206, 20 (authorizing up tyo aggregate capital commitments of 10%), 43 (authorizing General Partner to change the strategy of the Funds); RFPoF ¶46.	Respondents claim that the ALJ ignored evidence concerning the investment limitation of 5%, including a statement in the PPM authorizing capital commitments of up to 10%. In fact, the ALJ specifically discussed this provision ond found that it could not be reconciled with the 5% investment limitation in the PPM or with the repeated references to the 5% limitation in marketing materials. Accordingly, the ALJ found that the limitation was 5%.
70	The 5% figure was repeated in marketing materials and newsletters.	The ALJ erroneously concluded that marketing materials repeated the 5% limitation. Initial Decision 21. This finding mischaracterizes the evidence, relies strategy on unreliable evidence and ignores material other evidence.	Div. Ex. 214at 3, Div. Ex. 215 at 3, Div. Ex. 216 at 5, Div. Ex. 217 at 2. "The fund is limited to 5% in any one corporate investment at the time of investment." Div. Ex. 218 at 5.	DFPOP ¶ 26, 32, 35.	Ex. DX-206, 43 (authorizing General Partner to change the strategy of the Funds); RFPoF ¶24.	See above concerning Respondents' argument that the PPMs gave them the ability to change strategy.
71	Respondents' investments were not consistent with the 5% limitation. As of December 1, 2007, Fund I had capital contributions of $7,231,021.92, 5% of which is $361,551. Yet, as of that date Fund I had invested $495,705 in EnterConnect Inc., $400,000 in GOBS, $425,000 in Reddi Brake Supply Corp., and $518,800 in UFood Restaurant Group. As of December 31, 2008, Fund I had capital contributions of $16,620,511.5% of which is $831,025. Yet, as of that date Fund I had invested $1,392,000 in America West (eight notes totaling $925,000 and more than $467,000 in America West stock). As of December 31, 2009, Fund I had capital contributions of $18,358,002, of which 5% is $917,900. As of that date Respondents had invested $1,860,000 in America West (a $1,330,000 note and stock and royalties purchased for more than $530,000.) As of December 31, 2010, Fund I had capital contributions of $20,112,852, of which 5% is $1,005,623. As of that date Fund I had invested $2,255,500 in America West (twelve notes totaling $1,725,500 plus thestock and royalties that cost more than $530,000).	The ALJ erroneously concluded that Fund I did not meet the cap in 2007, 2008, 2009, or 2010. Initial Decision 21. This finding mischaracterizes the evidence, relies on unreliable evidence and ignores material other evidence.	Div. Ex. 231 at JBTOF 1692; Div. Ex. 301 at JTBOF 19257-59; Div. Ex. 315. Div.Ex. 301 at JTBOF 19209, 19211; Div. Ex. 316 at 11. Div. Ex. 301 at JBTOF 19166-67. Div. Ex. 317. Div. Ex. 301 at JTBOF 19130-31.	DFPOP 46-51.	Tr. 2758-2759; RX-3.	At Tr. 2758, Jarkesy attempts to explain how the Galaxy investment became larger than 5%. Jarkesy's testimony, however, does not explain how or why Respondents violated the limitation with respect to EnterConnect, Reddi Brake, or UFood in 2007, and America West in 2008, 2009, and2010. Indeed, Jarkesy admitted in 2011 that it was the "very large position" in America West that was responsible for the "wild swings" in the value of the Funds that was causing investor concern. DX-240.

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72	Belesis's input into decisions concerning portfolio companies and receipt of fees from such companies affected the degree of profit or loss that the companies might attain, directly affecting the returns, or lack thereof, of investors. To the extent that Respondents argue that the fees JTF/Belesis received were the result of agreements between JTF/Belesis and the companies, not JTCM/Jarkesy, Jarkesy was a director of America West and of Radiant, as was his affiliate Rodriguez who was also an officer of the companies. Thus, Jarkesy was involved in those companies' decisions and cannot disclaim responsibility for the fees the companies paid to JTF/Belesis.	The ALJ erroneously concluded that Belesis' input into decisions concerning portfolio companies and receipt of fees from such companies directly affected investors and losses. Initial Decision 29. This finding mischaracterizes the evidence, relies on unreliable evidence end ignores material other evidence.		DFPOP ¶¶ 145-149.	RX-327, p. 3-5; Tr. 558, 657- 658, 666, 688-694, 2659-2660, 2702-2703, 2708-2709, 2760-2761; RPFoP, ¶¶ 151-52.	Respondents' citations do not address the ALJ's conclusion that the excessive fees the portfolio companies paid had an impact on the ability of those companies to continue operations, which in turn, had a direct impact on the investors in the Funds. Jarkesy's testimony that the fees were not excessive is not credible and unreliable.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15255

In the Matter of	:
	:
JOHN THOMAS CAPITAL MANAGEMENT GROUP, LLC, d/b/a PATRIOT 28, LLC, and	:
	:
GEORGE R. JARKESY JR,	:
	:
Respondents.	:

CERTIFICATE OF SERVICE

I certify that on March 16, 2015, I have served the Opening and Response Brief of the Division newly formatted with the table of contents and table of authorities by overnight mail and/or e-mail on the following:

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