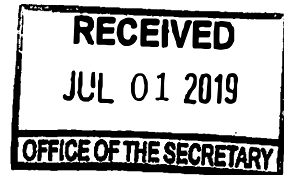
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-17184

In the Matter of

CHRISTOPHER M. GIBSON

Judge James E. Grimes

DIVISION OF ENFORCEMENT'S PREHEARING BRIEF

July 1, 2019

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INTRODUCTION

This matter involves fraudulent conduct and violations of statutory fiduciary duties by an investment adviser, Christopher M. Gibson ("Gibson"). From January 2010 until early 2013, Gibson was an investment adviser to the Geier International Strategies Fund, LLC ("GISF" or the "Fund"), a private investment fund that at one point had more than $70 million in assets under management. Gibson was the 50% owner and managing director of the entity that served as GISF's managing member, and was also 50% owner and President of the entity that served as GISF's investment manager. GISF's private offering memorandum told investors that "the success of the Company [GISF] is significantly dependent upon the expertise and efforts of Chris Gibson."

As an investment adviser to GISF, Gibson owed fiduciary duties to GISF under Section 206 of the Investment Advisers Act of 1940 ("Advisers Act"), 15 U.S.C. § 80b-6. These duties included the obligations to act for the benefit of GISF, put the interests of GISF before his personal interests, and act honestly and fairly in dealing with GISF. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194-203 (1963). Section 206 (1) and (2) of the Advisers Act prohibited Gibson from engaging in any conduct that, in light of his fiduciary duties, constituted a "device, scheme, or artifice to defraud" or "operate[d] as a fraud or deceit." 15 U.S.C. § 80b-6(1) and (2).

Additionally, Gibson's conduct toward GISF's investors was subject to Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Those provisions prohibited Gibson from making untrue or misleading statements to GISF's investors or engaging in any conduct that was fraudulent, deceptive, or manipulative with respect to investors. 15 U.S.C. § 80b(4); 17 C.F.R. § 275.206(4)-8.

Gibson's activities in connection with the purchase and sale of securities were also subject to the anti-fraud provisions in Section 10(b) of the Securities and Exchange Act ("Exchange Act")

and Rule 10b-5 thereunder. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. Those provisions prohibited Gibson from, *inter alia*, using a scheme to defraud or engaging in any conduct that operated as a fraud with regard to any person, including GISF and GISF's investors.

A. Gibson's Misconduct

Gibson achieved substantial gains for GISF in 2010, largely by investing in gold and silver. In return, he received more than $1.7 million in management fees, performance fees, and salary. Late that year, after discussion with GISF's largest investor, Gibson changed GISF's investment strategy, investing the majority of GISF's assets in Tanzanian Royalty Exploration Corporation ("TRX"), a Canadian company specializing in the exploration for gold reserves in Africa. By the end of April 2011, GISF held approximately 10% of TRX's issued and outstanding shares, an investment valued at over $70 million. However, the price of TRX shares soon began to fall. Between April and September 2011, the value of GISF's investment in TRX declined approximately 42%.

After deciding in late September 2011 to close out its entire position in TRX, Gibson repeatedly violated his fiduciary duties and defrauded GISF and GISF's investors by engaging in a series of transactions that created and exploited material, undisclosed conflicts of interest between himself and GISF or favored another party over the interests of GISF.

"Front Running" on September 26, 2011: During the weekend of September 24-25, 2011, Gibson consulted with GISF's largest investor, James Hull ("Hull"), and decided to sell GISF's entire TRX position. But before beginning to do so, on Monday, September 26, Gibson sold all of the TRX shares in his personal account, his then-girlfriend's account, and another account in which he had a financial interest, at an average price of $4.04 per share. The following day, Gibson sold 3.7 million TRX shares held by GISF, for approximately $3.50 per share. By trading for

himself and his girlfriend on September 26 based on his foreknowledge of GISF's anticipated sale of TRX, Gibson engaged in "front running" of his own client (GISF), a clear violation of his fiduciary duties and a fraud.

Unfair Trade Allocation/Favoritism in October 2011: In October 2011, Gibson favored the interests of Hull over the interests of GISF by arranging for GISF to buy all the TRX shares in Hull's personal account in a non-market transaction, thereby enabling Hull to exit a souring investment at a favorable price. Hull was GISF's largest investor, and throughout the relevant period Gibson provided investment advice to Hull regarding personal accounts maintained by Hull and members of Hull's family. As noted, Gibson had decided in late September 2011 that the Fund would liquidate its TRX holdings, and it continued to do so in October. Nevertheless, in mid-October 2011, Gibson directed the Fund to purchase over 680,000 TRX shares from Hull for $2.45 million. When Gibson sold GISF's entire investment in TRX three weeks later, GISF lost approximately $1 million on the shares purchased from Hull. Essentially, Gibson dumped a disadvantageous trade on GISF in order to benefit Hull, in violation of his fiduciary duties to GISF and his assurances to GISF and GISF's investors that they would be treated equally and fairly.

Front Running In October and November 2011: On five occasions in late October and early November 2011, Gibson again violated his fiduciary duties and engaged in fraud by using his knowledge of the anticipated sale of GISF's remaining TRX shares to benefit himself, his then-girlfriend, and his father (John Gibson). Knowing that he would soon be selling GISF's remaining TRX shares, and also knowing that liquidating GISF's large position was likely to depress the share price, Gibson bought put option contracts on TRX, with a strike price of $4, for his personal account and the account of his then-girlfriend. He also advised his father to purchase the same option contracts, and his father did so. This meant that if the share price fell below $4, Gibson and

his father would generate proceeds upon the sale of the option contracts in their personal accounts and mitigate their GISF-related TRX losses – and Gibson's girlfriend would profit upon the sale of her option contracts in her personal account.

Then on November 10, 2011, Gibson dumped all of GISF's remaining TRX shares (approximately 4.9 million shares) into the market. As TRX's price dropped, the option contracts held by Gibson, his girlfriend, and his father increased substantially in value. When the price of TRX shares was at its lowest point (and the $4 option contracts were most valuable), Gibson sold all of his and his girlfriend's $4 option contracts. His father sold on November 10 as well. This resulted in illicit profits for Gibson, his girlfriend, and his father of approximately $379,550 on the option contracts. In contrast, GISF lost more than $6 million on November 10, 2011. Because Gibson and his father were invested in GISF, the net effect of this front running was to mitigate the overall loss Gibson and his father experienced on November 10. The remaining GISF investors obtained no such loss mitigation.

B. <u>The Division's Claims</u>

By front running GISF's sale of TRX shares on September 26, 2011, and on multiple occasions in October and November 2011, and by favoring Hull to the disadvantage of GISF in mid-October 2011, Gibson (i) violated Sections 206(1) and 206(2) of the Advisers Act with regard to GISF and (ii) violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder with regard to GISF's investors. Each instance of front running, as well as the October 2011 purchase of Hull's TRX shares, also violated Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c) thereunder.

The Division expects to request that Gibson be ordered to cease and desist from violating the above-mentioned provisions and required to both disgorge the ill-gotten gains generated by his

violations, with prejudgment interest, and to pay civil penalties commensurate with his serious and repeated violations.

STATEMENT OF FACTS

Gibson Creates Geier Group As An Investment Adviser

Gibson was an asset securitization analyst at Deutsche Bank Securities in New York from June 2006 to February 2009. While at Deutsche Bank, he was involved in complex financial and securities transactions, including securitization and valuation of mortgage-backed securities. Gibson passed the General Securities Representative Exam (Series 7) and the Uniform Securities Agent State Law Exam (Series 63) in 2006, and passed the Uniform Investment Advisers Law Exam (Series 65) in 2009.

Shortly after leaving Deutsche Bank in February 2009, Gibson began providing investment advice to Hull (a Georgia commercial real estate developer), members of Hull's family, and two private investment funds (the Hull Fund and the Gibson Fund) holding money invested by Hull, Hull's business associates, Gibson, Gibson's father (John Gibson), and others.

On April 14, 2009, Gibson formed Geier Group, LLC ("Geier Group") as a Georgia entity. He registered Geier Group as an investment adviser under Georgia law on April 24, 2009, by filing Form ADV with the Financial Industry Regulatory Authority ("FINRA"). That Form ADV stated that Geier Group would provide "[p]ortfolio management for individuals and/or small businesses" and "[p]ortfolio management for businesses or institutional clients (other than investment companies)." The Form ADV also stated that Geier Group or a related party had discretionary authority to determine the "securities to be bought or sold for a client's account" and "the amount of securities to be bought or sold for a client's account." Geier Group's Form ADV identified

Gibson as the "person responsible for supervision and compliance" and as "President." Gibson owned 50% of Geier Group, Hull owned 35%, and Gibson's father owned 15%.

Gibson, Hull, and Gibson's father also owned a parallel Georgia entity, Geier Capital, LLC ("Geier Capital"), which was created in June 2009. However, Geier Capital's Operating Agreement did not take effect until January 1, 2010, at the same time GISF began operations, as discussed below. The ownership interests in Geier Capital were the same as in Geier Group. Geier Capital never registered as an investment advisor.

Gibson Creates GISF

Gibson created GISF on December 16, 2009, as a Delaware limited liability company. Hull assisted in the formation of GISF, providing administrative support and encouraging business associates and friends to invest in the Fund. GISF was created to replace both the Hull Fund and the Gibson Fund, and investors in those entities transferred their interests to GISF.

GISF's private offering memorandum, operating agreement, and subscription agreement were distributed to potential investors in January 2010. The private offering memorandum ("POM") identified Geier Capital (a Georgia entity) as the "Managing Member" of GISF and identified Gibson as "the Managing Director" of Geier Capital.[1] The POM also identified Geier Group as the "Investment Manager," with Gibson as "the managing member" of the Investment Manager. The POM also told investors that Geier Group was "registered in the State of Georgia as an investment adviser."

In early 2010, GISF raised approximately $32 million through a Regulation D private placement. Hull was the Fund's largest investor. Other investors included members of the McKnight

[1] Gibson subsequently created a Delaware entity also named Geier Capital, LLC, and in March 2011 the Georgia entity named Geier Capital, LLC was terminated. See below at note 4.

family of Georgia, other Georgia business associates and friends of Hull, Gibson's parents, and the father of Gibson's then-girlfriend. Gibson secured additional investments, including from new investors, through early 2011.

Gibson Was An Investment Adviser To GISF

Gibson acted as an investment adviser to GISF from its inception in January 2010 through early 2013. Gibson identified himself as an investment adviser, accepted and maintained discretionary control of GISF's funds, determined GISF's investment strategy (in consultation with Hull), directed GISF's trading on a daily and often minute-by-minute basis, selected GISF's brokers, opened brokerage accounts in GISF's name, transferred GISF funds among brokers and financial institutions, tracked the performance of GISF's investments, communicated with investors regarding GISF's performance, and provided market analysis and projections to GISF's investors.[2]

Gibson was compensated for his services as an investment adviser to GISF in the form of management fees, incentive fees, and salary. Pursuant to GISF's offering memorandum and GISF's operating agreement, Geier Group was entitled to an annual investment management fee equal to 1% of assets under management. GISF paid Geier Group investment management fees of $223,351 in 2010 and $295,005 in 2011. As 50% owner of Geier Group, Gibson was entitled to 50% of those fees.

GISF was also obligated to pay Geier Capital a 10% "incentive allocation" if GISF achieved an annual return in excess of a designated rate ("hurdle rate"). In 2010, GISF paid Geier Capital an incentive allocation of $3,147,283. As 50% owner of Geier Capital, Gibson received 50% of that incentive allocation, *i.e.*, $1,573,642. Gibson also received a salary from Hull, through one of Hull's

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[2] Gibson also signed the reports filed with the Commission on Forms D, 13G, 4 and 5 on behalf of GISF (and Geier Group and Geier Capital).

businesses, for advisory services to GISF. The amounts Gibson received in salary were: $73,953.51 in 2010,[3] $148,718.31 in 2011, $148,395.53 in 2012, and $6,271 in 2013.

GISF's Performance

At the end of 2010, GISF held assets valued at approximately $88.9 million. After discussions with Hull regarding the tax treatment of gains on commodities, Gibson, in late 2010, decided to greatly reduce GISF's gold holdings and instead invest most of GISF's assets in TRX, which was engaged primarily in exploration for gold resources in Tanzania. By late April 2011, GISF held approximately 9.7 million TRX shares.[4]

Although TRX had never been profitable, Gibson told investors that TRX shares could be expected to appreciate in response to an increased demand for gold. However, after April 2011,

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3 Because Geier Group later repaid Hull $75,000 to cover Gibson's 2010 salary, and Gibson was a 50% owner of Geier Group, Gibson's effective salary benefit in 2010 was $38,953.

4 In addition to altering GISF's investment strategy and holdings, in early 2011, Gibson made fundamental changes regarding GISF's investment manager (Geier Group) and GISF's managing member (Geier Capital):

Geier Group: Gibson allowed Geier Group's registration as an investment adviser to lapse in January 2011. He never told GISF's investors that Geier Group was no longer a registered investment adviser. In fact, after January 2011, Gibson solicited and obtained funds from two investors using the offering memorandum stating that Geier Group was a registered investment adviser. Then in April 2011, at Gibson's direction, Geier Group was dissolved. Gibson never told GISF's investors that the entity designated as the investment adviser had been dissolved. Gibson continued to make filings with the SEC in the name of Geier Group until at least November 2011. Gibson also continued to use a brokerage account in the name of Geier Group long after that entity ceased to exist.

Geier Capital: Geier Capital, the Georgia entity identified in the offering documents as the managing member of GISF, was dissolved on March 28, 2011, at Gibson's direction. Gibson never told GISF's investors that the managing member of GISF had been dissolved. Gibson continued to use the name "Geier Capital" in emails and other documents until early 2013. Gibson claims that Geier Capital was replaced as GISF's managing member by a Delaware entity Gibson had created in December 2010 that was also named Geier Capital and had the same members and ownership structure as the Georgia entity. Gibson never told GISF investors of any such substitution.

the price of TRX's common stock moved in the opposite direction, declining throughout the summer. The value of GISF's holdings, which consisted almost entirely of TRX shares, fell correspondingly.

While issuing optimistic projections to the investors, Gibson told TRX management in private communications that the company was failing. On August 10, 2011, Gibson told TRX management that he was "physically ill" over TRX's stock price and "[v]ery soon it will make sense to exit our positions. There is no time left." The same day Gibson told James Sinclair, TRX's Chairman, that "everything you say is always inaccurate." On August 15, 2011, Gibson told TRX management that "[w]e are running on fumes." In an email on Thursday, September 22, 2011, Gibson implied that the company's primary value was its cash, which would justify a price of only "$0.30" per share. He also stated that the company might not last for more than "4 more days" and urged management to seek a buyer.

On Friday, September 23, 2011, Gibson sent an update to investors acknowledging GISF's poor performance and stating that management fees would be waived beginning October 1, 2011, and "until further notice." But in contrast to his statements to TRX management, Gibson told the investors that there was "tremendous fundamental value" in "the assets owned and business operated by TRX" and that he believed in the "reputation, character, and integrity" of TRX's Chairman, James Sinclair. Gibson further stated that he expected the TRX stock price to rise to "significantly higher levels." Finally, Gibson assured investors that "[p]ersonally, I will not redeem my interest in Geier and TRX until the bull market matures over the coming years."

Gibson's "Front Running" On September 26, 2011

After a conversation with Hull about the strategic direction of the Fund over the weekend of September 24-25, 2011, Gibson decided to liquidate GISF's entire TRX position. Apart from Hull, none of the investors were told of this decision.

Gibson had previously purchased TRX shares in his personal brokerage account and two other accounts he controlled, *i.e.*, an account in the name of his then-girlfriend (Francesca Marzullo) and an account in the name of Geier Group. On Monday, September 26, 2011 (the first trading day after he assured investors that he would not redeem his interest in TRX for years), Gibson sold all of the TRX shares in his personal brokerage account (2,000 shares), Marzullo's account (18,900 shares), and Geier Group's account (1,000 TRX shares). Gibson sold these 21,900 TRX shares for approximately $4.04 per share.

Then on September 27, 2011, Gibson had GISF sell approximately 3.7 million shares at an average price of $3.50 per share. TRX's share price opened at $4.24 on September 27 and dropped over 16% during the day, closing at $3.54 per share.

By "front running" GISF's trading, Gibson exploited his position as GISF's investment adviser to personally benefit himself (by mitigating his anticipated GISF TRX-related losses) and his then-girlfriend (Marzullo). By trading ahead of his client, Gibson was able to sell all of the TRX shares in his personal account and in two accounts he controlled at a share price $0.50 higher than the price he obtained for GISF the following day. He did so without disclosing to his client (GISF) his intended conduct or the conflict of interest it created, and without obtaining the consent of his client, GISF.

Unfair Trade Allocation/Favoritism in October 2011

After GISF's September 27, 2011 sale, Gibson continued to seek buyers for GISF's

approximately 5.4 million remaining TRX shares. Nevertheless, by agreement dated October 18, 2011, Gibson agreed to use GISF's funds to buy all 680,636 TRX shares Hull held personally. GISF paid $3.60 per share, for a total cost to GISF of over $2.45 million. The shares were delivered to GISF on October 20, 2011, and GISF paid $2,450,589.60 to Hull the same day.

This private transaction enabled Hull to exit his entire personal TRX position at a known and favorable price, without the price-depressing impact of a large sale on the public market. It also allowed Hull to avoid paying a sales commission, which he would have been required to do if he had sold his shares in the open market. Moreover, by purchasing Hull's TRX shares, Gibson shifted the market risk and the commission cost from one client (Hull) to another (GISF). When Gibson sold GISF's entire remaining block of TRX shares in the market on November 10, 2011, the shares purchased from Hull were among those sold at a severely depressed price, *i.e.*, an average price of $2.02. Thus, GISF lost $1.58 per share, or $1,074,902, as a result of the October 2011 transaction with Hull. Additionally, GISF paid a sales commission it would not otherwise have incurred.

At the time of this transaction, Hull's real estate business (Hull Storey Gibson Companies, LLC) was paying Gibson a salary of approximately $148,000 per year for Gibson's advisory services to GISF. At the same time, Gibson was providing personal investment advice to Hull and Hull's family members. Gibson never told GISF's other investors of his salary from Hull, or that Gibson was providing investment advice to Hull regarding his personal accounts. Under these circumstances, Gibson's use of GISF funds to relieve Hull of the TRX shares in his personal account created a fundamental conflict of interest. But Gibson arranged for and executed the purchase from Hull without disclosing the transaction to GISF or GISF's investors.

Front Running In October and November 2011

In late October and early November 2011, Gibson again used his foreknowledge of anticipated large block sales of GISF's TRX shares to obtain a financial benefit for himself and his girlfriend, and in this instance his father as well. During this period, TRX shares were generally trading between $3.40 and $4.07. Knowing that he would soon be putting GISF's remaining TRX shares into the market, and also knowing that liquidating GISF's large position was likely to depress the share price, Gibson bought put option contracts on TRX with a strike price of $4 for his girlfriend's account on October 27, and then for his personal account and his girlfriend's account (again) on October 28. Gibson bought additional put contracts for his own account on November 2 and November 8. On November 9, Gibson told his father, John Gibson, to likewise buy $4 put contracts, and his father did so that day.

These option contracts gave Gibson, his girlfriend, and his father the right to require the sellers of those contracts to buy 251,900 shares of TRX at $4 per share, regardless of the prevailing market price. This meant that as GISF lost money because of the declining value of TRX shares, and the share price of TRX went below $4, Gibson, his girlfriend, and his father would profit upon the sale of the options contracts in their personal accounts. In effect, Gibson's purchase of the put contracts represented a short position, *i.e.*, a bet that TRX's share price would decline below $4 before the put contracts expired. Gibson knew that such a significant price decline was a likely result of his imminent sale of the large remaining block of the Fund's TRX shares.

The next day, November 10, 2011, as Gibson prepared to liquidate GISF's TRX position, he told his broker that "we are going to potentially tank this stock." Gibson then dumped GISF's remaining 4.9 million TRX shares into the market. The share price, which opened at $3.41,

immediately began to plummet, declining to $2.99 by 9:45 AM. At 9:52 AM, the New York Stock Exchange halted trading in TRX for five minutes due to the dramatic price drop. At 10:00 AM, shortly after the trading halt was lifted, and with TRX's share price down to $2.02, Gibson sold all the $4 TRX put contracts in his account. Two minutes later, he sold all of the $4 TRX put contracts in Marzullo's account. At 11:40 AM, Gibson's father sold all of his remaining $4 TRX put contracts.

Gibson's front-running scheme resulted in illicit proceeds on the $4 put options of $81,930 for Gibson, $254,380 for his girlfriend, and $43,240.01 for Gibson's father.[5] The total proceeds resulting from the sale of those contracts in their personal accounts was $379,550.01.[6] By means of this front running, Gibson mitigated the losses he and his father suffered that day on their investment in GISF, and he secured profit for his then-girlfriend and/or indirectly mitigated the losses of her father, who was also an investor in GISF.

Gibson devised and implemented this front running scheme over a period of two weeks (October 28 through November 10), which was more than adequate time to disclose the conflict of interest to his client and seek that client's consent. However, there is no evidence that Gibson disclosed his intended conduct to GISF, Hull, or anyone (apart from advising his father to purchase $4 put option contracts on TRX).

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5 Gibson on November 9, 2011, also told his father to sell all the TRX shares in his father's personal account. Gibson's father began liquidating his TRX position on November 9, 2011, at prices higher than he would have obtained for those shares on November 10 after GISF dumped its shares.

6 These figures reflect proceeds prior to commissions. After factoring in the commissions paid, the total net profit on the $4 option contracts was $374,711.68. (Gibson also bought $2 put option contracts for himself and Geier Group, and their combined profit on those $2 contracts, prior to commissions, was approximately $22,500.)

GISF After November 10, 2011

Gibson continued to manage GISF's investments in late 2011. In a December 2011 email, he claimed to Hull that he had worked tirelessly for GISF's investors, "placing their interests ahead of mine." Gibson also told Hull that "I am proud of my conduct." He continued to be paid a salary at the rate of approximately $148,000 per year, but did not take the 1% management fee after September 30, 2011, and did not earn an incentive fee for 2011.[7]

Gibson likewise managed GISF's investments throughout 2012. In May 2012, GISF had 20 investors and over $7 million under management. Gibson was paid a salary of $148,000 for his advisory services to GISF in 2012.

Gibson continued to manage GISF's investments in early 2013 as GISF sold its remaining holdings. On April 10, 2013, Gibson sent letters to 13 investors returning the remainder of their investments. By that date, GISF had ceased trading and Gibson's role as investment manager had ended. Gibson was paid $6,270 for his advisory services to GISF in early 2013.

ARGUMENT

I. Gibson Violated Sections 206(1) and (2) Of The Advisors Act.

Section 206(1) of the Advisers Act makes it unlawful for an investment adviser "to employ a device, scheme, or artifice to defraud any client or prospective client." 15 U.S.C. § 80b-6(1). Section 206(2) makes it unlawful for an adviser to "engage in any transaction, practice, or course of

[7] On December 22, 2011, Gibson dissolved Geier Capital, the Delaware entity he contends was GISF's managing member during the last half of 2011. *See* note 4 above. The dissolution was never disclosed to investors, and Gibson continued to use the name Geier Capital until at least April 2013. There is no evidence that any other person or entity was substituted for the dissolved entity as GISF's managing member. Nevertheless, Gibson continued to hold investors funds, make investment decisions, and otherwise act as an investment adviser with regard to those funds.

business which operates as a fraud or deceit upon any client or prospective client." 15 U.S.C. § 80b-6(2).

The Supreme Court has long held that Section 206 "establishes 'federal fiduciary standards' to govern the conduct of investment advisers." *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979) ("no doubt that Congress intended to impose enforceable fiduciary obligations"). Section 206 imposes affirmative duties on investment advisers, including the obligations to exercise "utmost good faith," make "full and fair disclosure of all material facts," and "employ reasonable care to avoid misleading clients." *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). *See also SEC v. DiBella*, No. 3:04cv1342 2007 WL 2904211, at *12 (D. Conn. Oct. 3, 2007); *SEC v. Moran*, 922 F. Supp. 867, 895-96 (S.D.N.Y. 1996)), *aff'd*, 587 F.3d 553 (2d Cir. 2009).

An investment adviser has a duty under Section 206 to disclose, among other things, "all conflicts of interest which might incline an investment adviser -- consciously or unconsciously -- to render advice which was not disinterested." *Capital Gains*, 375 U.S. at 191. *See also Vernazza v. SEC*, 327 F.3d 851, 859 (9th Cir. 2003) ("It is indisputable that potential conflicts of interest are 'material' facts . . . ."); *Steadman v. SEC*, 603 F.2d 1126, 1130 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

In an action under Section 206 of the Advisers Act, the Division need not prove that the investment adviser's violation caused injury to the client. *Capital Gains*, 375 U.S. at 195 ("Congress . . . did not intend to require proof of . . . actual injury to the client"). *See also Aaron v. SEC*, 446 U.S. 680, 693 (1980).

Section 206(1) of the Advisers Act is violated only if the adviser acted with scienter, which includes recklessness. *SEC v. Blavin*, 760 F.2d 706, 711-12 (6th Cir. 1985). However, simple

negligence is sufficient to establish a violation of Section 206(2) of the Advisers Act. *Capital Gains*, 375 U.S. at 195; *Steadman*, 603 F.2d at 1134. Negligence is "the failure to exercise the standard of care that a reasonably prudent person would have exercised in a similar situation .... The term denotes culpable carelessness." *In the Matter of Lisa Premo*, Admin. Proceedings Rulings Release No. 476, 2012 WL 6705813 at n.34 (Dec. 26, 2012).

Thus, to establish that Gibson violated Section 206(1), the Division must show that Gibson (i) was an investment adviser, (ii) breached his fiduciary duties through nondisclosure of material facts or otherwise engaged in a scheme to defraud, and (iii) acted at least recklessly. To establish violations of Section 206(2), the Division must establish that Gibson (i) was an investment adviser, (ii) breached his fiduciary duties through nondisclosure of material facts or otherwise engaged in a transaction or practice that operated as a fraud or deceit, and (iii) acted at least negligently.[8]

A. Gibson Was An Investment Adviser.

Pursuant to Section 202(a)(11), the term "investment adviser" includes, inter alia, any person "who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities." 15 U.S.C. § 80b-2(a)(11). Whether an individual is an investment adviser depends on the individual's conduct, not his or her title or position. *See In the Matter of John J. Kenny*, Admin. Proceedings Rulings Release No 8234, 2003 WL 21078085, at n.54 (May 14, 2003).

[8] The Division must also show that Gibson's violative conduct involved use of the mails or an instrumentality of interstate commerce. Telephones and the internet, both of which were employed by Gibson in the course of his violations, are instrumentalities of interstate commerce. *See, e.g., United States v. Nader*, 542 F.3d 713, 717 (9th Cir. 2008) ("Telephones are instrumentalities of interstate commerce"); *Utah Lighthouse Ministry v. Foundation for Apologetic Inf. & Research*, 527 F.3d 1045, 1054 (10th Cir. 2008) ("the Internet is generally an instrumentality of interstate commerce.").

The evidence will show that Gibson acted as an investment adviser to GISF throughout the period at issue. As noted above, Gibson performed all the key activities associated with investment advisory services – for example, he had discretionary control of client funds, developed investment plans and strategies, directed GISF's trading in common stocks, commodities, and options, selected GISF's brokers, opened and controlled brokerage accounts in GISF's name, tracked the performance of GISF's investments, communicated with investors regarding GISF's performance, and provided market analysis and projections. Gibson was compensated for his services as an investment adviser to GISF through management fees, incentive fees, and salary. Gibson received more than $1.7 million for advisory services to GISF in 2010, and at least $296,220 in 2011.

Because Gibson provided investment advice to GISF for compensation, he was an "investment adviser" under the Advisers Act, regardless of whether he was doing so in his individual capacity or as an officer or employee of an entity (such as Geier Group or Geier Capital), and regardless of what other positions he held or other functions he performed.

1. <u>Gibson Was an Investment Adviser Even After Waiving Management Fees Beginning October 1, 2011.</u>

Gibson apparently intends to argue that he was not an investment adviser as of October 1, 2011, because he waived collection of the management fee as of the end of September 2011 and was never subsequently successful in earning an incentive fee.[9] In essence, Gibson argues that he ceased being an investment adviser on October 1, 2011, not due to any change in his activities, but because as of that date he voluntarily decided not to collect the management fee.

The compensation element of the investment adviser definition "is satisfied by the receipt of *any economic benefit,* whether in the form of an advisory fee or some other fee relating to the

[9] Gibson's argument regarding his compensation after September 2011 does not impact the Division's claims based on Gibson's front running on September 26, 2011.

total services rendered, commissions, or some combination of the foregoing." Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Release No. 1092, 52 Fed. Reg. 38400, 38403 (October 16, 1987) (emphasis added). *See also United States v. Elliot*, 62 F.3d 1304, 1311 n.8 (11th Cir. 1995). The adviser's compensation need not come directly from the advisee; the only requirement is that the compensation is received by the adviser. *Id.* Nor must the compensation be "specifically earmarked as payment for investment advice." *United States v. Miller*, 833 F.3d 274, 282 (3d Cir. 2016).

The evidence will show, and Gibson does not deny, that he received an investment management fee from GISF in 2010 and through the end of September in 2011. Although Gibson voluntarily waived the management fee thereafter, he could have resumed collecting that fee again anytime. Gibson continued to have a contractual right to collect the management fee, even after September 2011.

Additionally, GISF was also obligated to pay a 10% "incentive allocation" if GISF achieved an annual return in excess of the designated "hurdle rate." Gibson never waived or revoked his right to receive the incentive payment if GISF's performance entitled him to that fee – he just did not achieve a return high enough to earn the fee in 2011. Had his investment strategies at any time in 2011 (including after September 2011) been sufficiently successful to generate an annual return for GISF in 2011 that exceeded the hurdle rate, Gibson would have been entitled to the incentive fee. Such a right to compensation (if earned) by strong performance satisfies the compensation element. *See SEC v. Fife*, 311 F.3d 1, 10-11 (1st Cir. 2002) (defendant found to be an investment adviser

where "he understood that he would be compensated for his efforts based on a percentage of the profits from the investments, *if successful*") (emphasis in original).

Finally, throughout 2011 (and thereafter) Gibson received a salary from Hull, through one of Hull's businesses, for advisory services to GISF. In 2011, that salary was $148,718.31. Gibson has testified that this salary was paid exclusively for the advisory services he provided to GISF.[10]

Thus, Gibson was serving as an investment adviser for compensation throughout the relevant period, including after September 2011.

2. An "Associated Person" May Also Be An Investment Adviser.

Gibson may also claim that he was not an investment adviser because he was within the definition of a "person associated with an investment adviser." In essence, Gibson claims that if he was associated with an entity that was an investment adviser, he could not himself have been an investment adviser. Section 202(a)(17) of the Advisers Act defines the term "persons associated with an investment adviser" to include, *inter alia*, any partner, officer, director, or (with certain exceptions) employee of an investment adviser. 15 U.S.C. § 80b–2(a)(17). Gibson argued previously that anyone falling within this definition — no matter how senior in the organization and no matter what advisory

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[10] Gibson Investigative Testimony, December 21, 2015, 419:13 – 422:15 (salary for 2010); 450:4 – 451:4 (salary for 2011). Moreover, even if Gibson's salary was compensation for advisory services to other clients, receiving compensation from *any* client for advisory services made Gibson an investment adviser within the scope of the Advisers Act with respect to *all* of his clients, even those clients from whom he did not receive compensation. *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222, 76 Fed. Reg. 39646, 39669 (July 6, 2011) ("Although a person is not an 'investment adviser'. . . unless it receives compensation for providing advice to others, once a person meets that definition (by receiving compensation from *any* client to which it provides advice), the person is an adviser, and the Advisers Act applies to the relationship between the adviser and any of its clients (whether or not the adviser receives compensation from them.)")

functions he performs — is excluded from the definition of "investment adviser." But nothing in the Advisers Act, Commission policy or regulation, or industry practice suggests that an "associated person" cannot also be an "investment adviser," *i.e.*, the two terms are not mutually exclusive. To the contrary, Section 202(a)(11) provides that an investment adviser is "any person" who engages in the specified activities for compensation. *See SEC v. Bolla*, 401 F.Supp. 2d 43, 59-61 (D.D.C. 2005) (holding that an associated person was an investment adviser); *Kenny*, Admin. Proceedings Rulings Release No 8234, 2003 WL 21078085 at n.54 (an individual associated with an investment adviser entity "may be charged as a primary violator under Section 206 where the activities of the associated person cause him or her to meet the broad definition of "investment adviser"").

Gibson's argument would mean that even the most senior officers and principals of investment advisory firms, who routinely provide investment advice for compensation, would not be investment advisers. Clearly that is not the case. *See SEC v. Gotchey*, No. 91-1855 1992 WL 385284 at *2 (4th Cir. Dec. 28, 1992) (holding that the president/half-owner of an investment advisory entity was an investment adviser); *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 378-79, 383 (S.D.N.Y. 2007) (holding CEO and president of investment adviser firms was an investment adviser). Indeed, if the "associated person" argument advanced on Gibson's behalf were adopted, hundreds or thousands of persons managing or employed by large advisory firms would no longer be investment advisers subject to the Advisers Act.

Thus, even if Gibson's investment advice to GISF was being provided in his capacity as a principal, officer, or employee, or in some other representative capacity (such as managing director of Geier Capital), Gibson was nevertheless an investment adviser.[11]

[11] Gibson may argue again that in order to bring him within the definition of "investment adviser," the Division is improperly treating Gibson as the alter ego of Geier Capital. However, the Division argues that Gibson is an investment adviser based on the actual advisory activities

3. <u>Gibson's Fiduciary Duties Were Not Waived or Satisfied by the Offering Memorandum's "Potential Conflicts of Interest" Provision.</u>

Gibson may also argue that even if he was an investment adviser, his fiduciary duties were either (i) waived by the "Potential Conflicts of Interest" provision in GISF's offering memorandum and similar language in GISF's operating agreement, or (ii) fully satisfied by in inclusion of that language in the offering documents. Gibson is wrong in both regards.

Gibson has claimed that his federal fiduciary obligations under Section 206 of the Advisers Act, including his obligation to disclose conflicts of interest and all other material facts, were waived by contract when the parties agreed to the terms in the offering documents. Gibson has argued previously that Delaware law permits the members of a limited liability company to waive certain state law duties of the managing member by contract. Gibson leaps from those Delaware law provisions to the conclusion that his federal duties and obligations under Section 206 of the Advisers Act can be nullified by contract. That claim ignores the vast and fundamental differences between the duties of a managing member under state law and any relevant contract provisions, and the statutory duties imposed on investment advisers under federal law. An investment adviser's federal statutory duties under Advisers Act Section 206 cannot be nullified by private agreement, or by the interaction of state law and private agreement. *See Burks v. Lasker*, 441 U.S. 471, 479 (1979) (federal securities laws displace state law where the state law would permit action prohibited by federal law); *SEC v. Keating*, No. CV 91–6785 1992 WL 207918 at *4 (C.D. Cal. July 24, 1992) ("[I]t would be impermissible to allow ... a creation of state law, to supersede the requirements, prohibitions and policies of the federal securities laws).

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he engaged in, regardless of whether he was acting individually or on behalf of Geier Capital, and regardless of whether he would be considered the alter ego of Geier Capital.

Second, Gibson may argue again that even if his federal fiduciary obligations were not voided or waived, his disclosure obligations were satisfied, once and for all time, by the inclusion of the "Potential Conflicts of Interest" provision in the GISF offering memorandum and comparable language in the GISF operating agreement. In essence, Gibson claims that this general language discussing only potential conflicts, which was provided to investors in January 2010, permitted him to create and exploit very significant actual conflicts 18 months later, in late 2011, without any further notice or disclosure to GISF or its investors.

Neither the language of these provisions nor industry practice supports Gibson's claim. While the potential conflict language in the offering documents noted that Gibson *might* engage in other business activities, and *might* give advice or take actions on behalf of others that differed from the advice he gave or action he took with regard to GISF, nothing in those provisions provided or could have provided that Gibson was authorized to conduct such other business activities in a way that violated his federal fiduciary duties to GISF. Nor could this, or any other contract language, nullify the other obligations and prohibitions imposed on Gibson under Advisers Act Section 206 or Exchange Act Section 10(b) and Rule 10b-5 thereunder. Certainly, the offering documents do not imply, let alone state, that Gibson could abuse GISF and act contrary to its best interests.

B. Gibson Violated Advisers Act Sections 206(1) and (2) By "Front Running" GISF On September 26, 2011.

The evidence presented at the hearing, including testimony by Division expert witness Dr. Gary Gibbons, will establish that "front running" refers to the illicit practice of "using advance

knowledge of impending client action to secure advantage."[12] The distinguishing feature of front running is an investment adviser's use, for personal gain, of material, non-public information concerning an anticipated transaction likely to impact the value of a security.[13] *See SEC v. Yang*, 999 F. Supp. 2d 1007, 1016 (N.D. Ill. 2013) (describing front running as an attempt by an adviser "to profit personally by secretly authorizing personal trades in anticipation of much larger trades he knew that he would be authorizing"). Front running creates a direct conflict of interest between the adviser and the client, and is universally recognized as a violation of fiduciary duties and Sections 206(1) and (2) of the Advisers Act. *See Capital Gains*, 375 U.S. at 196-97, 201 (1963); *Yang*, 999 F. Supp. 2d at 1016.

Gibson engaged in front running when he traded ahead of GISF on September 26, 2011. Beginning no later than the weekend of September 24-25, 2011, Gibson knew that GISF would be liquidating its large position in TRX. Gibson, after consulting with Hull that weekend, not only made the decision to exit GISF's TRX position, but personally controlled the timing and manner in which that position would be sold. Under these circumstances, Gibson's fiduciary duties mandated that he not trade on this material non-public information for his personal benefit, at least not until after specifically and timely disclosing this actual conflict of interest and obtaining informed client consent. But Gibson never told GISF, its investors, or anyone else of his plans to front run GISF's block sales.

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12 Bines, Harvey E. and Thel, Steve, *Investment Management Law and Regulation*, Second Edition, Aspen Publishers (March 14, 2006) at page 807.

13 Beare, Margaret E., *Encyclopedia of Transnational Crime and Justice*, SAGE Publications (Apr 24, 2012) at page 147. *See also* NASD (n/k/a FINRA) Rule IM-2110-3 and its superseding FINRA Rule 5270, both of which prohibit trading when the party subject to the rule "has material non-public market information concerning an imminent block transaction."

Instead, on Monday, September 26, 2011, Gibson sold all of the TRX shares in his personal brokerage account, the account of his girlfriend Francesca Marzullo, and an account in the name of Geier Group. Gibson sold these 21,900 TRX shares for approximately $4.04 per share. Then the next day, as anticipated based on his conversation with Hull, Gibson directed GISF's sale of approximately 3.7 million TRX shares. As Gibson was aware, putting this large block on the market predictably reduced the share price, and GISF obtained only an average price of $3.50 per share. Thus, by front running his client (GISF), Gibson was able to sell the shares in his personal account and two accounts he controlled at over $0.50 per share higher than the price GISF obtained the following day. This front running scheme violated Gibson's fiduciary duties to GISF, defrauded his client in violation of Advisers Act Section 206(1), and engaged in a transaction which operated as fraud in violation of Advisers Act Section 206(2).

1. Front Running Can Be Based On Knowledge Of A Client's Intention To Trade.

At the hearing, the Division expects Gibson to again argue for an extremely narrow definition of "front running." Gibson has claimed previously that there can be no front running unless all aspects of the anticipated client transaction (*e.g.*, price, time, and volume) are fixed in place, and are known to the investment adviser, before the adviser places the front running trade. Likewise, Gibson apparently will argue, through the expert report of Daniel Bystrom, that because Gibson did not have a firm order to sell, he therefore did not have the information of a pending sale of TRX of which he could take advantage. However, the accepted industry understanding of front running is much broader. For example, the relevant FINRA policy statement regarding front running makes clear that '[t]he violative practice ... may include transactions that are executed *based upon knowledge of less than all of the terms* of the block transaction, so long as there is knowledge that all of the material terms of the transaction have been or *will be* agreed upon

imminently." NASD (n/k/a FINRA) Rule IM-2110-3 (emphasis added). Knowledge of the client's intention to sell, rather than of the exact terms of the proposed sale, is sufficient to bar the adviser from trading ahead of the client. The Division will show, through *inter alia* the expert report and testimony of its expert Dr. Gibbons, that it is widely understood in the investment adviser community that the foreknowledge required to constitute front running is knowledge of the client's trading intentions. Thus, to prove that Gibson improperly traded ahead of GISF's September 27th sale of TRX, the Division need not show that all aspects of that sale were firmly in place on September 26, when Gibson sold TRX from his personal account and the accounts of his girlfriend and Geier Group.

C. Gibson Violated Advisers Act Section 206(1) and (2) By Arranging For GISF To Purchase All Of Hull's Personal TRX Shares In October 2011.

Because an investment adviser is a fiduciary, the adviser must not, without adequate disclosure and informed consent, favor any other party (even another client) over a particular client. But Gibson did exactly that in mid-October 2011 when he arranged for GISF to buy all of Hull's personal TRX shares, thereby transferring to GISF the risk and burden of selling these shares in a declining market, and also transferring $2.45 million in liquidity from GISF to Hull. Although GISF was seeking to sell its remaining 5.4 million TRX shares, on October 18, 2011, Gibson agreed to use GISF's funds to buy all 680,636 TRX shares held by Hull personally. This transaction enabled Hull to sell his entire TRX position at a known and favorable price, and to avoid paying a sales commission. In contrast, GISF's acquisition of Hull's TRX shares shifted the market risk and the commission cost to GISF. Then, when GISF sold its entire remaining block of TRX shares on November 10, 2011, the shares purchased from Hull were sold at severely depressed prices, resulting in a loss to GISF of over $1 million on these shares (as well as the obligation to pay the related sales commissions).

The prospect that Gibson might use GISF funds to relieve Hull of the risks associated with holding his personal TRX shares (of which he had 100% ownership) created a fundamental conflict of interest that should have been either fully disclosed and approved or avoided entirely. But Gibson did neither. By favoring Hull's interests over the interests of GISF, Gibson violated his fiduciary duties to GISF, defrauded his client in violation of Section 206(1), and engaged in a transaction which operated as fraud in violation of Section 206(2).

D. <u>Gibson Violated Advisers Act Sections 206(1) and (2) By Front Running In October and November 2011 Using Put Option Contracts.</u>

Gibson again engaged in front running on five occasions in October and November 2011. On October 27 and 28, 2011, Gibson purchased $4 put option contracts on TRX for the personal account of his girlfriend. On October 28 and November 2 and 8, 2011, Gibson purchased identical $4 TRX option contracts for his own personal account. Then on November 9, 2011, he advised his father, John Gibson, to purchase the same option contracts, and his father did so. Through these option contract purchases, Gibson placed his own financial interest, and the financial interests of his girlfriend and father, in direct conflict with the interests of his client, GISF. Because the option contracts would become valuable if the price of TRX shares declined below $4, Gibson and two persons close to him would profit if his client's major investment (its TRX holdings) fell in value. In effect, the put contracts represented a short position, *i.e.*, a bet that TRX's share price would decline below $4 before they expired. Gibson never disclosed this conflict of interest to GISF or its investors, nor did he give GISF or its investors the same opportunity he had given himself to hedge against their GISF-based TRX positions and mitigate future losses.

On November 10, 2011, Gibson carried out the anticipated liquidation of GISF's TRX holdings. When all of GISF's 4.9 million TRX shares were dumped into the market, the share price plummeted. Gibson then sold all the $4 TRX put option contracts in his account. Two

minutes later, he sold all of the $4 TRX option contracts in Marzullo's account. Gibson's father sold all his $4 TRX put option contracts soon thereafter. This front-running scheme resulted in illicit proceeds totaling approximately $379,550, in all three accounts.

By front running GISF's selling on November 10, Gibson used his position as GISF investment adviser, and specifically his foreknowledge of GISF's anticipated sale of its TRX shares, to benefit himself (by helping him mitigate his anticipated GISF losses), his then-girlfriend, and his father. As discussed above in connection with his similar misconduct on September 26, 2011, front running was a violation of Gibson's fiduciary duties to GISF, a fraud on his client in violation of Advisers Act Section 206(1), and a transaction which operated as fraud in violation of Advisers Act Section 206(2).

E. Gibson's Knowledge Of His Misconduct Cannot Be Attributed To GISF.

Gibson's violations of Advisers Act Sections 206(1) and (2) rest in part on his failure to satisfy his fiduciary duty to make full and fair disclosure to GISF of all material facts, including the conflicts of interest he created and exploited to his benefit and to the benefit of those close to him. That disclosure obligation was not satisfied, and could not have been satisfied, simply because Gibson was aware of his own misconduct and was (directly or through Geier Capital or any other entity) an agent of GISF. An agent's knowledge is not attributable to the principal when the agent is acting contrary to the interests of the principal. *SEC v. DiBella*, 587 F.3d 553, 568 (2d Cir. 2009). This "adverse interest exception" to general agency principles applies where "an agent is in reality acting . . . for his own personal interest and adversely to the principal." *Ruberoid Co. v. Roy*, 240 F.

Supp. 7, 9 (E.D. La. 1965). *See also Bank of China v. NBM LLC*, 359 F.3d 171, 179 (2d Cir. 2004); Restatement (Second) of Agency § 282(1).[14]

Gibson was acting contrary to the interests of his client, GISF, when he traded ahead of GISF on September 26, 2011, and on multiple occasions in October and November 2011. Likewise, he improperly favored Hull over GISF when he used GISF's funds to purchase Hull's shares in October 2011. Consequently, Gibson's knowledge of his own misconduct cannot be attributed to GISF, and he could not have consented on behalf of GISF to his own improper behavior.

II. Gibson Violated Advisers Act Section 206(4) and Rule 206(4)-8 Thereunder.

Section 206(4) of the Advisers Act prohibits an investment adviser from engaging in "any act, practice, or course of business that is fraudulent, deceptive, or manipulative." Liability under Advisers Act Section 206(4) can arise from simple negligence. *SEC v. Steadman*, 967 F.2d at 647 (D.C. Cir. 1992); *In the Matter of Tri-Star Advisors, Inc.*, Admin. Proceedings Rulings Release No. 1478, 2014 WL 11034264 at *8 (June 2, 2014); *SEC v. Quan*, Civil No. 11–723 2013 WL 5566252 at *16 (D. Minn. Oct. 8, 2013). Simple negligence is the "failure to exercise ordinary care," *i.e.*, the failure to use the "degree of care that a reasonably careful person would use under like circumstances." *SEC v. The Nutmeg Group*, No. 09–cv–1775 2016 WL 690930 at *13, (N.D. Ill. Feb. 18, 2016); *see also Bolla*, 401 F. Supp. 2d at 72.

Advisers Act Rule 206(4) applies to both registered and unregistered investment advisers. *SEC v. Rabinovich & Assoc., LP*, No. 07 Civ. 10547 2008 WL 4937360, at *4 (S.D.N.Y. Nov. 18,

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[14] Delaware law recognizes the adverse interest doctrine. *See Penn Mutual Life Insur. Co. v. Espinosa 2007-1 Ins. Tr.*, No. 09–300 2010 WL 3023402 at *9 (D. Del. July 30, 2010); *Lincoln Nat'l Life Ins. Co. v. Snyder*, 722 F. Supp. 2d 546, 555 (D. Del. 2010).

2008). Advisers Act Rule 206(4)-8(a)(1) prohibits an investment adviser to a "pooled investment vehicle"[15] such as GISF from making an untrue or misleading statement regarding a material fact to investors or prospective investors in such an investment fund, or failing to state material facts necessary to make statements to such investors not misleading. Advisers Act Rule 206(4)-8(a)(2) prohibits "any act, practice, or course of business that is fraudulent, deceptive, or manipulative" with respect "to any investor or prospective investor" in such a fund. *Nutmeg Group*, 2016 WL 690930 at *17; *Rabinovich & Assocs.*, 2008 WL 4937360 at *4 (S.D.N.Y. Nov. 18, 2008).

Gibson is liable under Advisers Act Section 206(4)-8 and Rule 206(4)-8(a)(2) thereunder if he intentionally, recklessly, or negligently engaged in any act or practice that was fraudulent, deceptive, or manipulative toward GISF's investors. Gibson's front running on September 26, 2011, his use of GISF's funds to enable Hull to exit his personal investment in TRX, and Gibson's front running on five occasions in late October and early November 2011 – all without disclosure to or approval from GISF's investors – were each fraudulent, deceptive, or manipulative towards GISF and its investors.

Front running by an investment adviser is inherently deceptive and fraudulent because it rests on the undisclosed misuse of confidential, non-public information for personal gain. Gibson's front running was manipulative as well, *e.g.*, he controlled the timing and manner of GISF's block sales and on November 10, 2011, used that control to "tank" the price of TRX shares at the beginning of the day, which maximized the value of his option contracts. Gibson's front running

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[15] Subsection (b) of Rule 206(4)-8 defines a "pooled investment vehicle" as any entity that is an "investment company" under Section 3(a) of the Investment Company Act of 1940 or would be an investment company under that section if not excluded by Section 3(c)(1) or 3(c)(7). 17 C.F.R. § 275.206(4)–8 (b). Those sections exclude from the definition of "investment company" funds that make no public offering and have only a limited number of investors or only investors meeting certain financial qualifications. GISF was such a fund and thus was a "pooled investment vehicle" subject to Rule 206(4)-8.

was also fraudulent and manipulative because he used his foreknowledge and control of GISF's anticipated selling to "pick winners and losers" among the GISF investors who also held TRX shares in personal accounts, *e.g.*, protecting himself, his father, and Hull by selling all of the TRX shares in the Geier Group account on September 26, and protecting his father by advising him on November 9 to sell his TRX shares and buy $4 put options. Other investors received no such solicitude, even though Gibson knew that many, including Mason McKnight IV and Matthew McKnight, also held TRX in personal accounts.

The Hull buyout transaction was also deceptive and fraudulent because it was contrary to the provisions of the GISF offering memorandum. That document provided that transactions between GISF and affiliated parties could be conducted only under certain conditions, including that the trade would be at the market price and without unusual commissions or fees. Neither of these requirements was met in connection with the Hull buyout transaction. As a result, it was deceptive and fraudulent for Gibson to spend $2.45 million in investor funds, without disclosure to the investors, to serve Hull's interest in exiting his TRX investment.

Additionally, Gibson is liable under Section 206(4)-8 and Rule 206(4)-8(a)(1) because he intentionally, recklessly, or negligently made untrue and misleading statements to GISF's investors. By stating generally that Gibson could engage in outside business activities and provide advice to others, but failing to disclose that he would use that authority to benefit himself and those close to him by front running GISF's trades and favoring Hull over GISF, the offering documents omitted material facts, making them misleading. Moreover, the private offering memorandum conveyed to GISF's investors that they would be treated fairly and equitably by the investment manager. Thus, when Gibson engaged in front running and used GISF's funds to purchase Hull's

TRX shares, he was acting contrary to the disclosures made to GISF's investors, which was fraudulent, deceptive, and manipulative in violation of Section 206(4) and Rule 206(4)-8 .

Gibson also made false or misleading statements to investors immediately prior to front running GISF in September 2011. On Friday, September 23, 2011, Gibson told investors that he believed there was "tremendous fundamental value" in "the assets owned and business operated by TRX" and that he believed in the "reputation, character, and integrity" of TRX's Chairman, James Sinclair. Gibson further stated that he expected the TRX stock price to rise to "significantly higher levels." Gibson then assured investors that "[p]ersonally, I will not redeem my interest in Geier and TRX until the bull market matures over the coming years." These statements were both material and misleading, and Gibson sold his entire personal interest in TRX on the next trading day, September 26, 2011.[16]

III. Gibson Violated Exchange Act Section 10(b) and Rule 10b-5 Thereunder.

Section 10(b) of the Exchange Act makes it unlawful, in connection with the purchase or sale of securities, to use "any manipulative or deceptive device or contrivance" in contravention of a rule issued by the Commission for the protection of investors. 15 U.S.C. § 78j(b). Exchange Act Rule 10b-5 is such a rule, and prohibits three overlapping types of deceptive conduct:

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[16] Gibson made several other false or misleading statements to GISF's investors in the POM (identified in note 4 above) in violation of Advisers Act Rule 206(4)-8(a)(1), which (like Exchange Act Rule 10b-5(b)) applies not only to statements that are false or misleading when made, but also to statements that subsequently become false or misleading but are not updated or corrected. *See In re Beacon Assocs. Litig.*, 745 F. Supp. 2d 386, 412-13 (S.D.N.Y. 2010) (duty to update applies to a statement made misleading by intervening events, even if the statement was true when made); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1431 (3d Cir. 1997) (holding that there is a duty to update "statements that, although reasonable at the time made, become misleading when viewed in the context of subsequent events").

subsection (a) prohibits the use of any "device, scheme, or artifice to defraud"; subsection (b) prohibits false or misleading statements or omissions; and subsection (c) prohibits "any act, practice, or course of business which operates . . . as a fraud or deceit on any person." 17 C.F.R. § 240.10b-5.

Subsections (a) and (c) of Exchange Act Rule 10b-5 create what is commonly referred to as 'scheme liability." *See Stoneridge Inv. Partners v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008); *United States v. Finnerty*, 533 F.3d 143, 148 (2d Cir. 2008); *SEC v. First Jersey Sec., Inc.*, 101 F. 3d 1450, 1471-72 (2d Cir. 1996); *SEC v. Brown*, 740 F.Supp.2d 148, 172 (D.D.C. 2010). Scheme liability under Rule 10b-5(a) and (c) may be based on deceptive conduct alone. *Hawaii Ironworkers Annuity Trust Fund v. Cole*, No. 3:10CV371 2011 WL 1257756 at *6-8 (N.D. Ohio Mar. 31, 2011); *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 328-29 (S.D.N.Y. 2004).

Scheme liability extends to those "who had knowledge of the fraud and assisted in its perpetration." *First Jersey Sec., Inc.*, 101 F.3d at 1471; *see also SEC v. Lee*, 720 F. Supp. 2d 305, 334 (S.D.N.Y. 2010) ("any person who substantially participates").

To establish that Gibson violated the "scheme liability" provisions of Exchange Act Rule 10b-5, the Division must show that in connection with the offer or sale of a security, and acting with scienter,[17] Gibson engaged in a scheme to defraud (for 10b-5(a) liability) or engaged in an act, practice, or course of business that operated or would operate as a fraud or deceit on any person (for 10b-5(c) liability). The Division need not show that Gibson's misconduct was directed to

[17] To prove scienter, the Commission must show "an intent to deceive, manipulate, or defraud," *Dolphin and Bradbury, Inc. v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008), or extreme recklessness, *Steadman*, 967 F.2d at 641. Scienter may be inferred from circumstantial evidence. *SEC v. Burns*, 816 F.2d 471, 474 (9th Cir. 1987).

GISF itself; liability can also be based on conduct addressed to, or impacting, GISF's investors. Nor must the Division establish that Gibson's conduct resulted in any harm to GISF, any investor, or to the investing public.

For purposes of Exchange Act Rule 10b-5 the Division need not show that Gibson was an investment adviser. However, because Gibson was an investment adviser, his fiduciary duties are considered in evaluating his potential liability under Exchange Act Rule 10b-5. "For the purpose of Rule 10b-5, an investment adviser is a fiduciary and therefore has an affirmative duty of utmost good faith to avoid misleading clients. This duty includes disclosure of all material facts and all possible conflicts of interest." *Laird v. Integrated Res., Inc.*, 897 F.2d 826, 833-34 (5th Cir. 1990); *See also In the Matter of Marc N. Geman*, Admin. Proceedings Rulings Release No. 1924, 2001 WL 124847 (Feb. 14, 2001), *aff'd, Geman v. SEC*, 334 F.3d 1183 (10th Cir. 2003).

Gibson violated subsection (a) of Exchange Act Rule 10b-5 by engaging in the multiple instances of front running discussed above and by using GISF's funds to relieve Hull of his investment in TRX in October 2011. On each of these occasions, Gibson, acting with intent or extreme recklessness, engaged in a scheme to defraud GISF and GISF's investors in connection with the offer or sale of securities.

Similarly, each time he traded ahead of GISF, and when he used GISF's funds to relieve Hull of his investment in TRX, Gibson violated subsection (c) of Exchange Act Rule 10b-5 by engaging, with intent or extreme recklessness, in an act or practice that operated as a fraud or deceit on GISF and GISF's investors in connection with the offer or sale of securities. *See SEC v. Donovan*, No. 08-CA-10649-RWZ, 2009 WL 7481557 (D. Mass. Nov. 20, 2009) (jury verdict finding trader violated Rule 10b-5 by using his mother's account to trade ahead of client orders); *see also SEC v. Bergin*, No. 3:13-cv-1940-M, 2015 WL 4275509 (N.D.Tex. July 15, 2015)

(employee of investment adviser charged with violating 10b-5(a) and (b) for front running client trades for benefit of wife's account), and *In the Matter of Daniel Bergin*, Admin. Proceeding No. 3-15775, Exchange Act Release No. 71656 (March 6, 2014) (settled follow-on administrative order imposing sanctions).[18]

CONCLUSION

Wherefore, based on Gibson's liability as will be established by the evidence admitted during the hearing, the Division expects to request that Hearing Officer enter an order requiring Gibson to (i) cease and desist from violating Section 206 of the Advisers Act and Rule 206(4)-8 thereunder, as well as Section 10(b) of the Exchange Act and subsections (a) and (c) of Rule 10b-5 thereunder; (ii) disgorge all ill-gotten gains resulting from his violations, with prejudgment interest; and (iii) pay civil penalties commensurate with the fraudulent nature of his violations and the substantial loss and risk of substantial loss created by his violations. *See* 17 C.F.R. §201.1004 (civil penalty tiers for violations after March 3, 2009 but before March 5, 2013).

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[18] Gibson's Answer asserts numerous affirmative defenses based on constitutional arguments. These arguments do not raise relevant factual issues to be addressed during the hearing, and will be discussed as appropriate by the Division in the post-hearing briefing. More specifically, the Division has objected and will continue to object to Gibson's effort to offer fact and expert witness testimony (or other documents) at the hearing, to support his claim that Division counsel made knowing misrepresentations to Hull during his investigative testimony (and in doing so, violated the SEC Enforcement Manual and ABA Model Rules of Professional Conduct) and therefore (somehow) deprived Gibson of a protected interest and/or his right to due process under the U.S. Constitution. The Division hereby incorporates by reference its prior filings addressing this issue, including: (1) the Division's Motion to Preclude Testimony of Current and Former Division Counsel filed May 24, 2019 (and Reply in support thereof, filed June 6, 2019); (2) the Division's Motion to Exclude Respondent Exhibits filed June 14, 2019 (and Reply in support thereof, filed June 28, 2019); and (3) the Division's Motion to Exclude Jeffrey Smith and Strike His Expert Report filed June 28, 2019.

July 1, 2019

Respectfully submitted,

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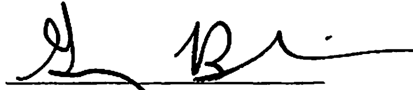
CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of July 2019:

(i) An original and three copies of the foregoing Division of Enforcement's Prehearing Brief were filed with the Office of the Secretary, SEC, 100 F Street, N.E., Washington, D.C. 20549-9303;

(ii) a copy of the foregoing Division of Enforcement's Prehearing Brief was sent to Thomas A. Ferrigino, counsel for Respondent, via email to thomas.ferrigno@mmlawus.com; and

(iii) a copy of the foregoing Division of Enforcement's Prehearing Brief was provided to Administrative Law Judge James E. Grimes, via email to *ALJ@sec.gov.*



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