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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3 - 18250

In the Matter of

Mark Megalli

Respondent.

DIVISION OF ENFORCEMENT'S REPLY IN SUPPORT OF ITS MOTION FOR SUMMARY DISPOSITION

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INTRODUCTION

Respondent Mark Megalli ("Megalli") was a securities professional who well knew that insider trading was illegal. Yet he contends that **no** associational restrictions are appropriate because his insider trading was not egregious and he did not have a high degree of scienter when he committed fraud. In so arguing, Megalli overlooks a long line of Commission decisions finding that insider trading is pernicious conduct that deserves severe sanctions, especially when perpetrated by securities professionals.

Megalli also argues that no associational restrictions should be imposed because such a sanction would be punitive and unnecessary given the sanctions already imposed on him. This argument conflicts with existing Commission decisions that have found such associational restrictions relief to be remedial. Even if associational restrictions were punitive, however, that does not preclude this Court from ordering such relief in this case. Indeed, the Commission has found that associational bars are presumptively appropriate in precisely the same circumstance as here: where the respondent has been criminally convicted for the same conduct.

Because the *Steadman* factors strongly support a severe sanction in this case, this Court should bar Megalli from association with an investment adviser.

DISCUSSION

A. The Steadman Factors Weigh In Favor of an Associational Bar

The parties agree that the decision of whether to impose any associational restrictions is guided by the well-established public interest factors listed in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd. on other grounds*, 450 U.S. 91 (1981). They include: (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infraction; (3) the degree of scienter involved; (4) the sincerity of the respondent's assurances against future

violations; (5) the respondent's recognition of the wrongful nature of his conduct; and (6) the likelihood of future violations.

Although no one factor is controlling, the Commission has repeatedly found that violations of the antifraud provisions of the federal securities laws are egregious and deserve the harshest of sanctions. *See, e.g.*, *In the Matter of Peter Siris*, Advisers Act Rel. No. 3736, 2013 WL 6528874 at *6 (Dec. 12, 2013) ("We have repeatedly held that conduct that violates the antifraud provisions of the securities laws is especially serious and subject to the severest of sanctions under the securities laws."), *pet. denied*, 773 F.3d 89 (D.C. Cir. 2014). Thus, the Commission has stated, "[O]rdinarily, and in the absence of evidence to the contrary, it will be in the public interest to suspend or bar from participation in the securities industry . . . a respondent who is enjoined from violating the antifraud provisions." *In the Matter of Vladimir B. Bugarski*, Exchange Act Rel. No. 66842, 2012 WL 1377357 at *5 (Apr. 20, 2012). *See also*, *In the Matter of Joseph Contorinis*, Initial Decision No. 503, 2013 WL 4478642 at *5 (Aug. 22, 2013) ("absent extraordinary mitigating circumstances, an individual who has been criminally convicted of misconduct specified in . . . Advisers Act Section 203(e)(2) cannot be permitted to remain in the securities industry."), *summarily aff'd.*, Advisers Act Rel. No. 3824, 2014 WL 1665995 (Apr. 25, 2014).[1]

1. Because Megalli was a Securities Professional, his Insider Trading was Egregious and Conducted with a High Degree of Scienter.

Megalli does not dispute that, at the time of his insider trading, he was associated with Level Global Investors, L.P. ("Level Global"), a registered investment adviser. Megalli knew

[1] Section 203(e)(2) of the Investment Advisers Act of 1940 authorizes the Commission to sanction any person associated with an investment adviser that has, within 10 years, been criminally convicted of a felony that, among other things, involves the purchase or sale of a security or arises out of the conduct of an investment adviser.

that Level Global had a policy that prohibited insider trading, and Megalli's employment agreement with that firm specifically provided that he would abide by that policy. Remedies Hearing Transcript, Exhibit A to Megalli Brief for Summary Disposition, at p. 70:7-10. Thus, Megalli was undeniably well-versed in the contours of insider trading, but nonetheless decided to commit insider trading. Accordingly, his conduct was egregious and conducted with a high degree of scienter. *See, e.g., In the Matter of Eric T. Burns*, Initial Decision No. 583, 2014 WL 1246758 at *5 (March 27, 2014), *made final* (May 8, 2014) (fact that Respondent was a licensed securities professional during the misconduct demonstrates a "fundamental misunderstanding of his responsibilities as a securities professional or demonstrates that he holds these obligations in contempt.") (Citation omitted).

Ignoring his heightened responsibilities as a securities professional, Megalli contends that his misconduct was not egregious or conducted with a high degree of scienter because (1) he did not personally profit from his illegal trades (2) he was a remote tippee that did not "induce any Carter's insider to breach a duty," and (3) the district courts in both his criminal case and the Commission's injunctive action against him ("the District Court Action") imposed minimal sanctions. Megalli Brief in Opposition to Division of Enforcement's Motion for Summary Disposition ("Megalli Opp. Brief") at pp. 18-20. But the Commission has emphasized that insider trading is egregious conduct. *In the Matter of Robert Bruce Lohmann*, Exchange Act Rel. No. 48092, 2003 WL 21468604 at *5 (June 26, 2003) (upholding a permanent, collateral bar and noting that "[i]nsider trading constitutes clear defiance and betrayal of basic responsibilities of honesty and fairness to the investing public") (internal quotation marks omitted). The Commission has thus not hesitated to impose permanent associational bars on securities professionals who commit insider trading. *See, e.g., In the Matter of Toby G. Scammel*, Advisers

Act Rel. No. 3961, 2014 WL 5493265 at *7 (Oct. 29, 2014) (Respondent's "misappropriation of material, nonpublic information for his own personal benefit and profit demonstrates that he is unfit to take on such heightened responsibilities [of a securities professional] in any capacity in the securities industry."); *Joseph Contorinis,* 2014 WL 1665995 (summarily affirming permanent associational bars); *Peter Siris*, 2013 WL at 6528874 at *6 (Respondents' insider trading was committed with high degree of scienter especially given his "long experience in the industry and admitted knowledge that he could not trade while in possession of material, non-public information."); *Lohman*, 2003 WL 21468604 at *5; *In the Matter of Martin B. Sloate*, Exchange Act Rel. No. 38373, 1997 WL 126707 (Mar. 7, 1997) (finding a bar with right to reapply after one year insufficient because "[a] registered securities professional who engages in the serious misconduct of insider trading should be excluded for a longer period of time."). *See also*, *In the Matter of David W. Baldt*, Initial Decision No. 418, 2011 WL 1506757 (Apr. 21, 2011), *made final* May 20, 2011 (permanent associational bar ordered based on securities professional's insider trading).

The fact that Megalli did not directly profit personally from his insider trading is irrelevant for purposes of the *Steadman* analysis; it is the gains and losses avoided that he created for Level Global. *Joseph Contorinis*, 2013 WL 4478642 at *5 ("The relevant consideration is not the personal benefit to the fraudfeasor; rather, it is the 'harm to investors and the degree of harm to the marketplace,' which, here, is more accurately measured by the total profits and losses avoided by the Fund through Contorinis' trades."). Megalli admits that he generated at least $2.6 million in profits and losses avoided for Level Global through his illegal trades in Carter's, Inc. stock. Respondent Mark Megalli's Answer to Order Instituting Administrative Proceedings at ¶ 2. The court in the District Court Action found those gains and losses avoided

significant. *SEC v. Megalli*, Case No. 1:13-cv-3783-AT, 2015 WL 13021472 at *4 (N.D. Ga. Dec. 15, 2015). This Court should reach the same conclusion.[2]

Megalli further attempts to diminish the severity of his misconduct by suggesting that his scienter was relatively low because the information provided by the tipper, Eric Martin, was "in the main, corroborated by [Megalli's] independent analysis and otherwise innocent due diligence." Megalli Opp. Brief at 23. Even if Megalli conducted some independent investigation into Carter's, however, he could not have been found liable in the District Court Action absent a finding that he *used* the material nonpublic information he received from Martin when he traded. *SEC v. Adler*, 137 F.3d 1325, 1336 (11th Cir. 1998) (SEC must show that defendant actually used inside information to be liable for insider trading). Because Megalli used information that he knew was improperly given to him when trading Carter's shares, he should not receive any benefit for any purported independent research.

2. Megalli's Insider Trading Was Not Isolated.

Megalli also contends that his misconduct was isolated because it only involved only two trading decisions in the stock of one issuer, *i.e.*, one decision to trade in advance of the October 2009 earnings announcement and another decision to trade in advance of the July 2010 announcement. Megalli Opp. Brief at 21. But during the Remedies Hearing in the District Court Action, Megalli admitted that, to effectuate the two trading decisions, he actually entered more

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[2] To the extent this Court views Megalli's personal profits as relevant, which it should not, his claim that he received "no meaningful compensatory benefit" from his insider trading deserves some skepticism. Megalli Opp. Brief at p. 18. Megalli was handsomely compensated by Level Global while executing the illegal trades at issue in this case, receiving $1.65 million in total compensation from that firm in 2010. Remedies Hearing Transcript, Ex A to Megalli Motion for Summary Disposition, at p. 14:6-10. Megalli would likely not have received any of this had Level Global learned of his illegal October 2009 insider trading, as his employment agreement specified that violations of the firm's insider trading policy authorized the firm to terminate him for cause. *Id.* at pp. 70-71.

than two trades. Remedies Hearing Transcript, Exhibit A to Megalli Brief for Summary Disposition, at pp. 84-86. Moreover, the court in the District Court Action found Megalli's misconduct was not isolated. *SEC v. Megalli*, 2015 WL 13021472 at *4 ("Nor does the Court consider Megalli's conduct 'isolated.'"). And the Commission has barred securities professionals from association even when the insider trading only occurred with respect to one security. *See, e.g., Toby Scammel*, 2014 WL 5493265 at *6-7. Thus, this Court should find Megalli's conduct was recurrent, rather than isolated.[3]

3. Megalli's Assurances against Future Misconduct and Purported Recognition of the Wrongfulness of His Actions Do Not Outweigh the Egregiousness and Severity of His Violations.

Megalli further contends that he should not receive any associational restriction because he has given sincere assurances that he will not commit future violations of the federal securities laws and has accepted responsibility for his action. Even if the Court finds that Megalli has truly accepted responsibility for his actions and is sincere in his assurances that he will not violate the law going forward, that does not mean that "there can be no risk of future misconduct warranting

[3] Megalli's opposition brief does not mention that, while the summary judgment in favor of the Commission in the District Court Action was based only on Megalli's trading prior to two earnings announcements by Carter's (because those were the only trades alleged in the criminal case), the Commission's complaint alleged illegal trading in advance of four earnings announcements. *See, e.g.*, Div. Ex. F; Order Instituting Proceedings at ¶ 2. Moreover, the Government in the parallel criminal case identified a fifth instance of improper trading in advance of Carter's April 28, 2010 earnings announcement. *U.S. v. Megalli*, Case No. 1:13-cr-00442-RS (N.D. Ga.) [Dkt 27 at p. 9]. This additional trade was not included in either the criminal case or the District Court Action, however, because the market did not respond to the announcement of those earnings as Megalli had anticipated and, thus, Level Global did not realize any profit from those trades. *Id.* The failure to realize any profits from these trades does not, however, detract from the conclusion that those trades were illegal. *See* 18 Donald C. Langevoort, *Insider Trading: Regulation, Enforcement & Prevention*, Sec. 5.2 (2005) ("Once information is properly deemed material as of the time of its receipt, it is irrelevant whether any predictions or promises contained therein in fact pan out.").

a bar." *In the Matter of Edgar R. Page*, Advisers Act Rel. No. 4400, 2016 WL 3030845 at *8 (May 27, 2016), *citing Peter Siris*, 2013 WL 6528874, at *6. Rather, the Commission must "weigh such assurances against the other *Steadman* factors in assessing the public interest." *Id.* *See also*, *In the Matter of Gary Kornman*, Exchange Act Rel. No. 59403, 2009 WL 367635 at *11 (Feb. 13, 2009) (holding that respondent's assurances against future misconduct, even if accepted as "sincerely given," did not prevent a finding that a bar was in the public interest, when considered in conjunction with the other *Steadman* factors).[4]

Here, the insider trading was perpetrated by a securities professional who undeniably knew of the proscriptions against insider trading. He blatantly disregarded that knowledge, showing that his conduct was egregious and committed with a high degree of scienter. These factors favor a bar regardless of whether Megalli's assurances against future violations are viewed as sincere.[5]

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[4] Megalli suggests that his lack of a disciplinary history also weighs in favor of no sanction in this case. Megalli Opp. Brief at p. 28. The Commission has expressed a contrary view. *See, e.g., In the Matter of Philippe N. Keyes*, Exchange Act Rel. No. 54723, 2006 WL 3313843 at *6 (Nov. 8, 2006) ("[L]ack of disciplinary history is not mitigating for purposes of sanctions because an associated person should not be rewarded for acting in accordance with his duties as a securities professional.").

[5] In addition to his prolonged challenge to his criminal conviction and his liability in the District Court Action, Megalli's opposition brief in this matter also raises questions as to whether he has truly acknowledged the wrongfulness of his conduct. Specifically, in arguing that he had a relatively low level of scienter, Megalli completely ignores the heightened responsibilities flowing from his position as a securities professional. *Toby Scammel*, 2014 WL 5493265 at *7 ("All securities professionals have heightened responsibilities to safeguard [material nonpublic] information and not to misuse their access to sensitive or confidential information for their own financial gain."); *In the Matter of John Lawton*, Advisers Act Rel. No. 3513, 2012 WL 6208750 at *11 (Dec. 13, 2012)("The industry relies on the fairness and integrity of all persons associated with each of the professions covered by the collateral bar to forgo opportunities to defraud and abuse other market participants."), *vac'd. on other grounds*, Advisers Act Rel. No. 4402, 2016 WL 3030847 (May 27, 2016).

B. The Supreme Court's Decision in *Kokesh* Does Not Preclude an Associational Bar against Megalli.

Megalli argues that, after the Supreme Court's decision *Kokesh*[6], associational restrictions should be viewed as punitive, and he suggests that such relief is thus not appropriate in this case given the punishment that he has already received from the District Court Action and the criminal proceeding. Megalli Opp. Brief at pp. 19-23. This argument fails for at least two reasons.

First, the Commission has held that associational restrictions are remedial, rather than punitive. *In the Matter of Timbervest*, Advisers Act Rel. No. 4197, 2015 WL 5472520 at *15 (Sept. 17, 2015) ("Barring the Timbervest partners from associating with an investment adviser is not 'punishment' nor is it 'punitive' because such bars protect investors in the future from unfit professionals."). In arguing for a different conclusion, Megalli relies on the concurring opinion in *Saad v. SEC*, 873 F.3d 297 (D.C. Cir. 2017). But the *Saad* matter is currently before the Commission, *In the Matter of Saad*, Exchange Act Rel. No. 82348, 2017 WL 6462614 (Dec. 18, 2017), and this Court must follow Commission opinions like *Timbervest* unless and until the Commission revises its precedent.

Second, even if this Court were to find the associational restrictions to be punitive, which it should not, that would not automatically preclude such a remedy in this case. Congress has specifically authorized the Commission to institute administrative proceedings for the purpose of determining whether to bar or suspend a person from association with an investment adviser, if that person has either been enjoined from certain violations of the federal securities laws, or criminally convicted of certain crimes. Investment Advisers Act of 1940, Section 203(f). In

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[6] *Kokesh v. SEC*, ___ U.S. ___, 137 S.Ct. 1635 (2017).

other words, Congress has determined that the Commission should assess whether it is appropriate to remove convicted felons or those enjoined from certain conduct from the securities industry. Thus, the fact that Megalli has previously been sanctioned in prior federal court proceedings in no way deprives the Commission from deciding whether some type of associational restriction is also appropriate. Nor would a finding that associational restrictions are punitive require this Court to deviate from the traditional *Steadman* analysis in deciding whether a restriction is appropriate. *See In the Matter of Harris et al.*, Initial Decision No. 1213, 2017 WL 4942807 at *9 (Oct. 30, 2017) ("I have weighed the relevant factors, and even assuming that a permanent bar is punitive under *Kokesh*, my analysis of those factors remains the same."). *See also*, *Bugarski*, 2012 WL 1377357 at *5 (rejecting argument that the "imposition of additional remedial action against [Respondent in a follow-on administrative proceeding] would be simply adding to the severe sanctions that have already been imposed and therefore would not be in the public interest.").

C. The Purported Delay in Instituting This Proceeding Does Not Undermine the Need for Relief.

Megalli argues that the Division of Enforcement's ("the Division's") delay in instituting this administrative proceeding suggests that the Division does not view an associational restriction as necessary to protect the public interest. Megalli Opposition Brief at pp. 14-15. But the delay stems from Megalli's own actions.

Megalli's liability in the District Court Action was based on the collateral estoppel effect of Megalli's criminal conviction. *SEC v. Megalli*, 157 F. Supp.3d 1240, 1250 (N.D. Ga. 2015) ("Accordingly, issue preclusion applies to this matter."). Megalli admits as much, stating that the court found in favor of the Commission on liability in the civil injunctive action, "[b]ased largely on Mr. Megalli's guilty plea ...." Megalli Brief in Support of his Motion for Summary

Disposition at p. 4. But, once he obtained credit from the sentencing judge in the criminal case for waiving any *Newman* defense, Megalli promptly launched a collateral attack on his criminal conviction on *Newman* grounds. Because the criminal conviction was the basis for civil liability and the ensuing injunction that authorized this proceeding, it made sense for the Commission to await a decision on Megalli's habeas petition before instituting this administrative proceeding. The district court rejected the habeas petition and denied Megalli a certificate of appealability on September 25, 2017 (*See* Div. Ex. B). The Commission commenced this administrative proceeding less than three weeks later, on October 12, 2017. Thus, there was no undue delay in instituting this proceeding.

CONCLUSION

For all the foregoing reasons, the Court should award Summary Disposition to the Division and permanently bar Megalli from association with an investment adviser.

Respectfully submitted this 16th day of January, 2018,

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CERTIFICATE OF SERVICE

Undersigned Counsel for the Division of Enforcement hereby certifies that he has served a copy of the DIVISION'S REPLY IN SUPPORT OF ITS MOTION FOR SUMMARY DISPOSITION by electronic mail and by United Parcel Service, addressed as follows:

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