In the Matter of

SCOTT G. MONSON

OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Causing Violations of Forward Pricing Rule

General Counsel of registered broker-dealer charged with causing broker-dealer's violations of Investment Company Act Rule 22c-1. Held, proceeding is dismissed.

APPEARANCES:

Eric Lee Dobberteen, of Clark & Trevithick, P.C., and Shane W. Tseng, of Arnold & Porter LLP, for Scott G. Monson.

Gregory C. Glynn and Karen Matteson, for the Division of Enforcement.

Appeal filed: July 3, 2007
Last brief received: September 28, 2007

I.

The Division of Enforcement ("Division") appeals from the decision of an administrative law judge dismissing cease-and-desist proceedings against Scott G. Monson, the former general counsel of broker-dealer JB Oxford & Company ("JBOC" or the "Firm") and its publicly-traded
parent company, JB Oxford Holdings, Inc.  

The order instituting these proceedings ("OIP") alleged that JBOC facilitated thousands of late trades in over 600 mutual funds for several institutional clients from June 2002 through September 2003, in violation of Rule 22c-1 of the Investment Company Act of 1940, which requires funds, their principal underwriters, dealers, and others authorized by the funds' prospectuses to consummate transactions in the funds to sell and redeem fund shares at a price based on the current net asset value ("NAV") next computed after receipt of an order to buy or redeem.  

The OIP alleged that Monson was a cause of these violations because of his role in drafting a "Mutual Fund Procedural Agreement" (the "Agreement").  The Agreement permitted the client to "confirm and activate" mutual fund trades after 4:00 p.m. Eastern time.  As alleged in the OIP, JBOC used the Agreement to establish trading relationships with several new clients who engaged in late trading.  The OIP alleged that Monson was a cause of JBOC's violations because he knew or should have known that his work on the Agreement would contribute to those violations.  

As the case has come to us on appeal, the Division contends that Monson caused JBOC's violations because he negligently departed from the standard of care for attorneys by failing to "ascertain whether the [A]greement, as used and to be used, would comply with . . . applicable laws and regulations governing his highly regulated client."  Although such a claim potentially warrants our consideration of factors that have motivated the Commission's traditional reluctance to bring an administrative action against a lawyer for the negligent rendering of non-public legal advice to his or her own client, there is no need to do so here because, as discussed more fully below, the record does not show by a preponderance of the evidence that Monson acted negligently with respect to the Agreement.  We base our decision upon an independent review of the record except with respect to those findings not challenged on appeal.  

II. 

Monson joined JBOC's predecessor company in 1989 after a brief career focusing on family law, real estate law, misdemeanor criminal defense, and property law.  Monson admittedly knew nothing about securities when he joined the Firm.  Monson has never held any securities licenses

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1/ In 2003, JBOC transferred its accounts to another wholly-owned subsidiary of JB Oxford Holdings, Inc., Stocks 4 Less, Inc.  JBOC was renamed National Clearing Corporation ("NCC") and provided clearing and execution services to broker-dealers and also acted as a market-maker.  In 2006, NCC filed with the Commission an application to withdraw its registration as a broker-dealer, and its registration has since been terminated.  

2/ 17 C.F.R. § 270.22c-1.  The illegal practice of permitting a purchase or redemption order received after the fund calculates its NAV (typically 4:00 p.m. Eastern time) to receive the same day's NAV is referred to as "late trading."  

3/ Monson moved to supplement the record pursuant to Commission Rule of Practice 452, 17 C.F.R. § 201.452, by seeking to admit an April 6, 2007 letter from Monson's counsel to the administrative law judge regarding a change in Monson's employment status.  Because this letter was already included in the record before us, Monson's motion is denied as moot.
and, he testified, learned primarily while on the job throughout his career at JBOC. At all relevant
times, Monson was the only practicing lawyer on staff at JBOC. Monson spent the vast majority of his time ("90, 95 percent") working on litigation matters, including suits brought by JBOC's customers, arbitrations, subpoena responses, production of documents, and customer complaints. Monson also served as a resource for other departments when they came to him for specific legal guidance, but had no supervisory authority over any departments or individuals, other than his own administrative assistant.

In approximately May 2002, JBOC's Chief Executive Officer, James Lewis, developed a new relationship on the Firm's behalf with an institutional client in Europe interested in mutual fund trading. Lewis met with Monson and with Kraig Kibble, JBOC's Assistant Vice President in charge of Operations who held several securities licenses. During this meeting, Lewis assigned Monson the task of drafting a contract setting forth the terms of mutual fund trading Lewis had negotiated with the new client. Lewis directed Monson to concentrate on the Agreement's indemnification provisions and to obtain additional account insurance through the Securities Investor Protection Corporation ("SIPC"). Lewis assigned Kibble the task of determining the trade cutoff times to be included in the Agreement.

Monson created a draft using a sample form agreement provided by the new client as the basis for his work, focusing on drafting the indemnification and fee provisions. The section regarding trade submission times was left largely unchanged from the provisions in the sample

\[4/\text{James Lewis, President and Chief Executive Officer of JBOC as well as President and Chief Operating Officer of JBOC's parent, was a lawyer by training, but, according to Monson, did not "act[] in a capacity as a lawyer on behalf of the companies."}\]

\[5/\text{In a related proceeding, Lewis, without admitting or denying the allegations in the complaint, consented to the entry of a district court order enjoining him from future violations of Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5 and imposing a civil penalty of $200,000 plus disgorgement of $1.00 in settlement of charges related to the Firm's facilitation of late trades. SEC v. JB Oxford Holdings, Inc., Case No. CV 04-07084PA (VBKx) (C.D. Cal. Jan. 25, 2006). Lewis also settled related Commission administrative proceedings. Without admitting or denying the allegations in the OIP, Lewis agreed to be barred from associating with any broker-dealer for five years. James G. Lewis, Order Instituting Proceedings, Securities Exchange Act Rel. No. 53210 (Feb. 2, 2006), 87 SEC Docket 911.}\]

\[6/\text{Like Lewis, Kibble consented to the entry of a district court order enjoining him from future violations of Exchange Act Section 10(b) and Rule 10b-5 without admitting or denying the allegations in the complaint; he was ordered to pay a civil penalty of $50,000. SEC v. JB Oxford Holdings, Inc., Case No. CV 04-07084PA (VBKx) (C.D. Cal. Oct. 7, 2005). Kibble also settled Commission administrative proceedings. Without admitting or denying the allegations in the OIP, Kibble agreed to be barred from associating with any broker-dealer for four years. Kraig L. Kibble, Order Instituting Administrative Proceedings, Exchange Act Rel. No. 52728 (Nov. 3, 2005), 86 SEC Docket 1998.}\]
form agreement. The sample agreement, and Monson's early draft, provided that the customer must submit its list of proposed transactions by "3:30 p.m. New York time" and confirm the trades by "4:00 p.m. New York time." The record is unclear whether it was Kibble or Lewis who later directed Monson to change the Agreement to provide that the customer could submit proposed orders until 4:15 p.m. and confirm them by 4:45 p.m. However, no version of the Agreement stated that JBOC would secure the same day's NAV for trades entered by the cutoff time.

Monson did not have experience in mutual fund trading and did not know how mutual funds were priced. He testified that he did not recognize that the Agreement contemplated violations of the securities laws, and he asked no questions about the timing of the trading activity contemplated by the Agreement. No one at the Firm consulted Monson about the propriety of the Agreement or its terms with the possible exception of Jonathan Cotledge, who worked in JBOC's mutual fund department. Cotledge testified that he asked Monson "whether it is all right to trade after 4:00." However, Cotledge, at the time, believed that trading after 4:00 p.m. was legal; he testified that he simply wished to know whether, from an operational and practical standpoint, it was possible to enter trades after 4:00 p.m. At the hearing, Cotledge did not recall what Monson's answer was. Monson was not asked about this conversation.

The Agreement Monson drafted was ultimately used by JBOC to establish trading relationships with seven clients. These seven clients placed and/or confirmed many mutual fund orders with JBOC after 4:00 p.m., the time at which all of the funds in which these clients traded calculated their NAV, as provided in the funds' prospectuses. Nevertheless, instead of receiving the next calculated fund share price, these seven clients' trades received that same day's (stale) NAV.

III.

Under Section 9(f) of the Investment Company Act of 1940, a person may be subject to remedial action as a cause of a violation of Investment Company Act Rule 22c-1 if the Division establishes that (1) a primary violation occurred; (2) an act or omission by the respondent contributed to the violation; and (3) the respondent knew or should have known that his conduct would contribute to the violation. The law judge found that the Division established the first

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7/ In a related civil proceeding, the Commission won partial summary judgment against JBOC, which the district court found had facilitated late trades and violated Rule 22c-1. SEC v. JB Oxford Holdings, Inc., No. CV 04-07084PA (VBKx) (C.D. Cal. Aug. 24, 2005). JBOC eventually settled the civil proceeding. Without admitting or denying the allegations against it, JBOC agreed to be permanently enjoined from committing future violations of Rule 22c-1 and the antifraud provisions of Exchange Act Section 10(b) and Rule 10b-5 thereunder and to pay combined disgorgement and penalty amounts of over $2 million. See SEC Settles Civil Fraud Charges Against JB Oxford Holdings, National Clearing Corporation, and Three Former Officers for Fraudulent Late Trading and Market Timing, Lit. Rel. No. 19641 (Apr. 5, 2006), 87 SEC Docket 473.

8/ 15 U.S.C. § 80a-9(f). The "should have known" language in Section 9(f) invokes a simple negligence standard for liability when the primary violation does not require (continued...)
two elements, and Monson has not appealed those findings. However, with respect to the third element of causing under Section 9(f), the law judge stated that "the record clearly shows that Monson did not intentionally violate Rule 22c-1." He further found that the Division failed to meet its burden to show that "Monson should have known that his conduct would result in JBOC's late trading."

Specifically, the law judge found that the Division failed to demonstrate that Monson, whose ignorance of Rule 22c-1 and mutual fund trading in general is undisputed, should have known that his work on the Agreement would contribute to JBOC's violations because he was negligent in failing to "spot the issue' that Rule 22c-1 could be implicated." In rejecting the Division's contention, the law judge observed that "Monson's scope in drafting the Procedural Agreement was limited." The law judge also pointed out that Monson's first draft included times that complied with Rule 22c-1, and that Monson inserted new, later times only at the direction of others: "Based on Monson's limited scope in drafting the Procedural Agreement and his reliance on Lewis, as CEO, Kibble, as Assistant Vice President of Operations, and Cotledge, who had operations experience, Monson did not act negligently in accepting the trade times that they instructed." Moreover, the law judge noted that the Agreement, on its face, "does not raise sufficient 'red flags,'" because the Agreement does not explicitly provide that post-4:00 p.m. trades would receive that day's NAV. The law judge credited the testimony of Monson's expert that "a lawyer of ordinary skill and capacity 'would not have recognized that the insertion of a time after 4:00 p.m. Eastern time in the draft procedural agreement could involve a violation of Rule 22c-1'" and found that "[i]t was not until someone other than Monson interpreted and implemented the Procedural Agreement that a violation occurred."

IV.

On appeal, the Division does not argue that Monson knew that his acts or omissions would contribute to JBOC's violation of Rule 22c-1. Instead, it argues that Monson should have known that his work on the Agreement would have contributed to JBOC's violation. The Division contends that "the ultimate question in determining Monson's negligence," and therefore whether he can be found to have caused his company's violation, "is what a reasonable attorney in Monson's position, acting with due care, would have done." Monson allegedly "failed to conform to basic professional standards regarding competence."

Thus characterized on appeal, the charges against Monson hinge on his role as a legal advisor to JBOC. The Division essentially contends that, by not having requisite knowledge of the securities laws and by failing to conduct further legal inquiry regarding trade timing issues in connection with the drafting of the Agreement, Monson was negligent in providing legal advice to his client.

8/ (...continued)

Over twenty-five years ago, in William R. Carter, 9/ we recognized particular concerns attendant to disciplining lawyers based on faulty legal advice and noted a distinction between actions with scienter and those without scienter. We held that, to sanction a lawyer pursuant to former Rule of Practice 2(e) for having aided and abetted a securities law violation, 10/ the Commission had to show "that respondents were aware or knew that their role was part of an activity that was improper or illegal." 11/ In confirming this "intent requirement" for aiding and abetting, we emphasized the "[s]ignificant public benefits [that] flow from the effective performance of the securities lawyer's role." 12/ We also recognized that, "[i]n the course of rendering securities law advice, the lawyer is called upon to make difficult judgments, often under great pressure and in areas where the legal signposts are far apart and only faintly discernible." 13/ We expressed concern that, to the extent lawyers exercising their professional judgment are excessively motivated by "fear of legal liability or loss of the ability to practice before the Commission," clients may well decide not to consult lawyers on difficult issues. 14/

Given these considerations, we eschewed a standard that would expose an attorney to professional discipline "merely because his advice, followed by the client, is ultimately determined to be wrong." 15/ The intent requirement, we said, is crucial to an allegation of wrongdoing by a lawyer because it "provides the basis for distinguishing between those professionals who may be appropriately considered as subjects of professional discipline and those who, acting in good faith, have merely made errors of judgment or have been careless." 16/

For some time after Carter, the Commission exercised restraint under Rule 2(e) by initiating "proceedings against attorneys only where the attorney's conduct has already provided the basis for a judicial or administrative order finding a securities law violation in a non-Rule 2(e) proceeding." 17/ When we acknowledged this practice, in connection with a 1988 rulemaking regarding Rule 2(e), we stated that "the Commission, as a matter of policy, generally refrains from using its administrative forum to conduct de novo determinations of the professional obligations of

10/ Our former Rule 2(e) has been expanded and recodified as current Rule 102(e) of the Commission's Rules of Practice, 17 C.F.R. § 201.102(e).
11/ Carter, 47 S.E.C. at 504.
12/ Id.
13/ Id.
14/ Id.
15/ Id.
16/ Id.
attorneys." 18/ We also noted that we sought to "minimize[] the risk . . . that public disciplinary proceedings may have a chilling effect on zealous representation of a client, particularly when the attorney appears before the Commission as an advocate in an enforcement matter." 19/ Consistent with these practices and policies, and with our reasoning in Carter, we have refrained from bringing disciplinary proceedings against lawyers under Rule 2(e) and its successor, Rule 102(e), based on negligent legal advice. 20/

Concerns about the scope of liability that have motivated our restraint with respect to Rule 102(e) actions against lawyers similarly are present in litigated administrative enforcement actions such as this case alleging that a lawyer caused another person's violation of the securities laws. The charges against Monson as framed by the Division – that Monson departed from professional standards of competence in rendering private legal advice to their clients – raise the same risks we identified in Carter and other proceedings: an encroachment by the Commission on regulation of attorney conduct historically performed by the states; 21/ interference with lawyers' ability to

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19/ Disciplinary Proceedings Involving Professionals Appearing or Practicing Before the Commission, 53 Fed. Reg. at 26,431 & n.32. As Greene observed in his speech, "[l]awyers may view the Commission's disciplinary actions as requiring them to divide their loyalties, and their clients may perceive that the threat of disciplinary actions interferes with effective representation." Greene at 170.

20/ The Commission retains authority under Section 4C(a) of the Exchange Act, 15 U.S.C. § 78d-3(a), and Rule 102(e)(1)(ii) of the Commission's Rules of Practice to deny to any person the privilege of appearing or practicing before it if the Commission finds the person "to have engaged in unethical or improper professional conduct." Although since 1988 the Commission has instituted at least one disciplinary proceeding against a lawyer in circumstances that did not involve a prior finding of a securities law violation, such cases have been infrequent and, true to the holding in Carter, have involved allegations of scienter-based misconduct.

21/ See Disciplinary Proceedings Involving Professionals Appearing or Practicing Before the Commission, 53 Fed. Reg. at 26,431; Simon Lorne & W. Hardy Callcott, Administrative Actions Against Lawyers Before the SEC, 50 Bus. Law. 1293, 1320-21 (1995) (hereinafter "Lorne & Callcott") ("Questions regarding the activities of lawyers that are couched in terms of the standard of ordinary care more clearly verge into the territory of professional ethics and state law and away from the statutory mandate and expertise of a federal agency such as the SEC."). We recognize that Congress in Section 307 of the Sarbanes-Oxley Act required the Commission to adopt minimum standards of (continued...)
provide unbiased, independent legal advice regarding the securities laws; 22/ and chilled advocacy on behalf of clients in proceedings before the Commission. 23/ As far as we are aware, we have not sanctioned attorneys in litigated enforcement proceedings based on alleged negligent acts or omissions they may have committed in providing non-public legal advice to clients.

This is not to say that lawyers have fallen outside the Commission's regulatory purview. To the contrary, the Commission has established that it will pursue cases against lawyers who allegedly violate the securities laws with scienter, 24/ render misleading opinions used in public

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21/ (...continued)
professional conduct for attorneys appearing and practicing before the Commission in the representation of issuers, see 15 U.S.C. § 7245, which we did, see 17 C.F.R. Part 205, and nothing in this opinion is intended to affect those requirements.

22/ Carter, 47 S.E.C. at 504.

23/ Disciplinary Proceedings Involving Professionals Appearing or Practicing Before the Commission, 53 Fed. Reg. at 26,431 & n.32. To be clear, none of the concerns mentioned in the text would warrant restraint in initiating proceedings alleging scienter-based misconduct by lawyers that threatens the integrity of Commission processes. See infra notes 24-26 and accompanying text.

24/ See Benjamin G. Sprecher, 52 S.E.C. 1296 (1997) (imposing penny stock bar on attorney with special expertise in securities law who "masterminded an elaborate fraudulent scheme involving a merger . . . to evade the registration requirements of the Securities Act" based on criminal conviction for conspiracy to sell unregistered securities and make false statements to the Commission as well as perjury and obstruction of justice); see also SEC v. Fehn, 97 F.3d 1276 (9th Cir. 1996) (affirming district court injunction against attorney on the grounds that he substantially assisted his client in the preparation of misleading disclosure statements and improperly advised his clients regarding material omissions in those disclosure statements); H. Thomas Fehn, Exchange Act Rel. No. 40697 (Nov. 20, 1998), 68 SEC Docket 1875 (accepting Fehn's consent to be denied the privilege of appearing or practicing for eighteen months before the Commission under Rule 102(e) based on the injunction affirmed by the Ninth Circuit in SEC v. Fehn); SEC v. Calvo, 689 F. Supp. 53 (D. Conn. 1988) (granting summary judgment to SEC and imposing injunction on attorney found to have recklessly violated, and recklessly aided and abetted violations of, antifraud provisions during public stock offering).
disclosures, or engage in conduct that would render a non-lawyer liable for the same activity under comparable circumstances.

The present case, however, does not require us to address further the appropriate parameters of lawyer liability in administrative enforcement actions because the record does not show by a preponderance of the evidence that Monson acted negligently in drafting the Agreement. In drafting the Agreement, Monson was told by management to focus on the amount of SIPC insurance needed to cover the anticipated investment by the new client and to ensure that the indemnification and fee provisions were properly drafted. The responsibility for determining the trade cut-off times – the aspect of the Agreement that ultimately made the trading arrangement illegal – was given to another Firm official, and Monson was never asked to evaluate regulatory issues related to those trading times. In addition, Monson's regular professional responsibilities as general counsel, and his understanding of what the Firm expected of him, are inconsistent with a finding that he was negligent because the Firm did not generally rely on Monson to determine whether the Firm's activities complied with securities laws and regulations.

Moreover, we do not find that circumstances surrounding the new trading arrangement necessarily should have alerted Monson, given his background and responsibilities, to the need for inquiry. The Agreement could have been fully implemented by the parties without engaging in

25/ See Ira Weiss, Exchange Act Rel. No. 52875 (Dec. 2, 2005), 86 SEC Docket 2588 (finding that school district's bond counsel negligently violated Securities Act Sections 17(a)(2) and (3) through the issuance of a misleading, unqualified opinion that he knew would be communicated to, and relied upon by, prospective investors, and through his review and approval of the issuer's official statement that referenced his opinion), aff'd, 468 F.3d 849 (D.C. Cir. 2006).

26/ See, e.g., Conrad C. Lysiak, 51 S.E.C. 841, 842 (1993) (finding that company's compliance officer, who was also "an experienced securities lawyer [and the company's] outside general counsel for many years," failed to enforce reasonable supervisory measures necessary to prevent violations of NASD rules), aff'd, 47 F.3d 1175 (9th Cir. 1995) (Table); Restatement (Third) of the Law Governing Lawyers § 56 cmt. b (2000) ("Lawyers are subject to the general law. If activities of a nonlawyer in the same circumstances would render the nonlawyer civilly liable or afford the nonlawyer a defense to liability, the same activities by a lawyer in the same circumstances generally render the lawyer liable or afford the lawyer a defense.").

Irrespective of the Commission's record in litigating enforcement actions against lawyers for negligent, non-public legal advice, the Commission might assert a scienter-based charge against a lawyer for conduct related to legal advice when the facts appear to support such a charge, and then, based on many different factors including its discretion, accept a settlement with the lawyer that alleges only a negligence-based violation. Cf. Lorne & Callcott at 1322-23 (arguing that any Commission policy to abjure from bringing administrative enforcement proceedings against negligent attorneys should not operate to deny attorneys the choice to settle proceedings in the administrative context).
violative conduct. Although the Division points to Cotledge's inquiry as a "red flag," it is unclear
from the circumstances that Monson should have been concerned about the implications of Cotledge's question; Cotledge testified that, when he asked Monson whether entering post-4:00 p.m. trades was "all right," Cotledge was interested only in learning whether the contemplated trading was permissible from an operations – not a legal – perspective.

Under all the circumstances, and based on our de novo review of the record in this case, we have concluded that the record before us does not establish by a preponderance of the evidence that Monson was negligent. 27/ We accordingly dismiss this proceeding. 28/

An appropriate order will issue. 29/

By the Commission (Chairman COX and Commissioners ATKINS and CASEY).

Florence E. Harmon
Acting Secretary

27/ The Division takes exception to the law judge's decision to grant Monson's motion in limine to exclude the testimony of two expert witnesses. The law judge concluded after reviewing the reports of all three of the Division's proffered expert reports that their testimony was duplicative and offered the Division the choice of presenting any one of the three experts, of the Division's own choosing. Rule of Practice 320, 17 C.F.R. § 201.320, provides that "the hearing officer may receive relevant evidence and shall exclude all evidence that is irrelevant, immaterial or unduly repetitious." As we have previously noted, the Supreme Court has made clear that "judges have broad discretion in determining whether to admit or exclude evidence, and 'this is particularly true in the case of expert testimony.'" Pagel, Inc., 48 S.E.C. 223, 230 (1985) (quoting Hamling v. United States, 418 U.S. 87, 108 (1974)). Having reviewed the reports of all three experts, we conclude that the law judge did not abuse his discretion in limiting the Division to one expert's testimony.

28/ Monson has requested oral argument. Under Rule of Practice 451(a), 17 C.F.R. § 201.451(a), we grant requests for oral argument with respect to the review of initial decisions of hearing officers except in "exceptional circumstances." However, because the issues in this case have been thoroughly briefed, and given the resolution of this matter, we believe there is "no prejudice" to Monson in denying his request for oral argument. D.E. Wine Invs., Inc., 54 S.E.C. 1213, 1221 n.25 (2001). We therefore deny his request.

29/ We have considered all of the contentions advanced by the parties. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.
UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Rel. No. 28323 / June 30, 2008
Admin. Proc. File No. 3-12429

In the Matter of
SCOTT G. MONSON

ORDER DISMISSING PROCEEDINGS

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

ORDERED that the administrative proceeding against Scott G. Monson be, and it hereby is, dismissed.

By the Commission.

Florence E. Harmon
Acting Secretary