Initial Decision Release No. 1259
Administrative Proceeding
File No. 3-17387

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of

Donald F. ("Jay") Lathen, Jr.,
Eden Arc Capital Management, LLC, and
Eden Arc Capital Advisors, LLC

Initial Decision on Equal Access to Justice Act Application
August 30, 2018

Appearances: Sarah H. Concannon, Nancy A. Brown, Judith Weinstock, Janna I. Berke, and Lindsay S. Moilanen for the Division of Enforcement, Securities and Exchange Commission

Harlan Protass, Protass Law PLLC, and Paul Hugel and Christina Corcoran, Clayman & Rosenberg LLP, for Applicants

Before: Jason S. Patil, Administrative Law Judge

Introduction and Procedural History

On August 16, 2017, I dismissed the proceeding against Donald F. Lathen, Jr., Eden Arc Capital Management, LLC (EACM), and Eden Arc Capital Advisors, LLC (EACA), finding that they had committed no violations of the securities laws. *Donald F. ("Jay") Lathen, Jr.*, Initial Decision Release No. 1161, 2017 WL 3530992, https://www.sec.gov/alj/aljdec/2017/id1161jsp.pdf (Initial Decision). No petition for review was filed, and the Securities and Exchange Commission ordered that my decision become final on November 2, 2017. *Donald F. ("Jay") Lathen, Jr.*, Securities Act of 1933 Release No. 10434, 2017 SEC LEXIS 3494. On December 5, 2017, EACM and EACA (Applicants)

filed an application under the Equal Access to Justice Act (EAJA), 5 U.S.C. § 504, for the recovery of legal fees and expenses.[1] The application represented that Applicants have met EAJA's eligibility requirements and that the Division of Enforcement's position in the litigation was not substantially justified. *See* 5 U.S.C. § 504(a)(2). The application included documentation of Applicants' net worth and an itemized statement of the "actual time expended" on the case "and the rate at which fees and other expenses were computed." *Id.*; *see* 17 C.F.R. §§ 201.42, .43.

Applicants supplemented their application with filings dated December 15, 22, and 29, 2017, and January 17, 2018, including signed net worth statements and supporting financial documentation for Applicants, Lathen, and Eden Arc Capital Partners, LP (the Partnership).[2] *Accord Scarborough*, 531 U.S. at 423 ("a timely filed EAJA fee application may be amended, out of time" to establish eligibility). The Division submitted an answer on February 14, 2018, arguing that no fees should be awarded. *See* 17 C.F.R. § 201.52; *see also Donald F. ("Jay") Lathen, Jr.*, Admin. Proc. Rulings Release No. 5533, 2018 SEC LEXIS 266, at *3–4 (ALJ Jan. 25, 2018) (extending answer deadline). Applicants replied on March 1, 2018, and included an additional declaration and exhibits estimating Lathen's net worth as of the August 15, 2016, order instituting proceedings (OIP). *See* 17 C.F.R. § 201.53. Oral argument was held on March 8, 2018, after which I directed Applicants to submit additional evidence clarifying the value of certain items in Lathen's

---

[1] An EAJA application must be filed within thirty days of the Commission's "final disposition of the proceeding," which is the date "a decision or order disposing of the merits of the proceeding or any other complete resolution of the proceeding . . . becomes final and unappealable, both within the Commission and to the courts." 17 C.F.R. § 201.44(a), (b); *see* 5 U.S.C. § 504(a)(2); *Adams v. SEC*, 287 F.3d 183, 186 (D.C. Cir. 2002). Because I cannot categorically say that the Commission's November 2, 2017, finality order was unappealable, I deem the application timely, as the period for a potential appeal had not yet lapsed when it was filed on December 5, 2017. *See* 15 U.S.C. § 78y(a)(1); *Adams*, 287 F.3d at 191; 17 C.F.R. §§ 201.51, .151(a), (b). In any event, the thirty-day deadline is not jurisdictional, and the Division of Enforcement does not dispute that the application was timely filed. *See Scarborough v. Principi*, 531 U.S. 401, 414 (2004) (construing parallel EAJA deadline provision for federal judicial proceedings); Answer at 5 n.2.

[2] Applicants also emailed my office a one-page verification dated December 20, 2017, which I have caused to be made part of the record of the proceeding kept with the Secretary.

financial disclosures. *See* 17 C.F.R. § 201.55; *Donald F. ("Jay") Lathen, Jr.*, Admin. Proc. Rulings Release No. 5642, 2018 SEC LEXIS 704, at *1 (ALJ March 12, 2018). Applicants submitted the information on March 26, 2018.[3]

All Commission administrative proceedings were stayed by order of the Commission from June 21 until August 22, 2018, in light of *Lucia v. SEC*, 138 S. Ct. 2044 (2018), where the Supreme Court held that because the administrative law judge who initially decided that matter was not properly appointed by the Commission in conformity with the Constitution and the petitioner raised a timely challenge to the appointment, the petitioner was entitled to a new hearing before a different, properly appointed official. *Pending Admin. Proc.*, Securities Act Release No. 10522, 2018 SEC LEXIS 1774 (July 20, 2018); *Pending Admin. Proc.*, Securities Act Release No. 10510, 2018 SEC LEXIS 1490 (June 21, 2018). On August 22, the Commission lifted the stay, reiterated its approval of the appointments of its administrative law judges as its own, and gave parties an opportunity for a new hearing before a different administrative law judge than the one previously assigned. *Pending Admin. Proc.*, Securities Act Release No. 10536, 2018 SEC LEXIS 2058. On August 29, 2018, Applicants submitted a letter to the Chief Administrative Law Judge stating that they waive any right under *Lucia* to a new hearing before a different judge, and elect to proceed with their claims before me. On the same day, the Division submitted a letter concurring with Applicants' request.

As discussed below, I find that Applicants meet EAJA's eligibility requirements. However, I also find that the Division's position in the litigation was substantially justified. I therefore deny the application.

Factual Background and Summary of Initial Decision[4]

In 2011, Respondents established a hedge fund to profit from bonds and certificates of deposit offered by sophisticated financial institutions. Because the investments could be redeemed early for their full value under survivor's options if a joint owner died, Lathen established joint accounts with

---

[3] The Division also filed the PowerPoint slides it used at oral argument, and there was an additional round of briefing on the information presented in the slides.

[4] *See generally* Initial Decision; *Donald F. ("Jay") Lathen, Jr.*, Admin. Proc. Rulings Release No. 5051, 2017 SEC LEXIS 2867, at *2, *4–5 (ALJ Sept. 15, 2017).

terminally ill individuals, and upon their deaths, redeemed the investments and assigned the profits to his fund, the Partnership.

In August 2016, the Commission accused Respondents of violating Section 17(a) of the Securities Act, and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities. The OIP asserted that Respondents knowingly, recklessly, or negligently made misrepresentations or omissions of material facts to the issuers of the survivor's option investments. Lathen allegedly made false statements to issuers that he and the terminally ill participants were joint tenants with a right of survivorship and failed to disclose to issuers the side agreements that he signed with the Partnership and the participants. I found that even assuming that the agreements or any other fund documents would have been material to issuers in assessing Lathen's representations that he was a joint owner of the accounts, Respondents lacked intent to defraud. Lathen acted in good faith, soliciting extensive advice from legal counsel. Based on the advice he received, he believed that his investment strategy was legal, the joint accounts were valid, and that he was not required to make further disclosures to issuers. I also found that Respondents were not negligent because the Division failed to establish the appropriate standard of care.

EACM, the investment adviser to the Partnership, was also charged with violating Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-2 thereunder—known as the custody rule. The Division alleged that Lathen and EACM placed the Partnership's funds and securities in brokerage accounts titled in the name of Lathen and various third parties, but should have custodied those funds in an account under the Partnership's name, or alternatively, in an account that contained only the Partnership's funds and securities under EACM's name as agent or trustee for the Partnership. Lathen was charged with aiding, abetting, and causing the alleged custody rule violation. I found, however, that the custody rule applies only to "*client* funds and securities," and the client Partnership never intended to become the owner of the funds in the joint accounts, as doing so would have invalidated the entire investment strategy.

Legal Background

The Administrative Procedure Act codifies EAJA's requirements as follows:

> An agency that conducts an adversary adjudication shall award, to a prevailing party other than the United

> States, fees and other expenses incurred by that party in connection with that proceeding, unless the adjudicative officer of the agency finds that the position of the agency was substantially justified or that special circumstances make an award unjust. Whether or not the position of the agency was substantially justified shall be determined on the basis of the administrative record, as a whole, which is made in the adversary adjudication for which fees and other expenses are sought.

5 U.S.C. § 504(a)(1). "The governing principle of the Act is that the 'United States should pay those expenses which are incurred when the government presses unreasonable positions during litigation.'" *Matthews v. United States*, 713 F.2d 677, 683–84 (11th Cir. 1983) (quoting *Goldhaber v. Foley*, 698 F.2d 193, 197 (3d Cir. 1983)). EAJA is a partial waiver of sovereign immunity and thus must be strictly construed. *Kirk Montgomery*, Exchange Act Release No. 45161, 2001 WL 1618266, at *10 (Dec. 18, 2001). EAJA applies to this administrative proceeding. *See* 5 U.S.C. § 504(b)(1)(C); 17 C.F.R. § 201.33(a).

The statute further provides the following requirements for an EAJA application:

> A party seeking an award of fees and other expenses shall, within thirty days of a final disposition in the adversary adjudication, submit to the agency an application which shows that the party is a prevailing party and is eligible to receive an award under this section, and the amount sought, including an itemized statement from any attorney, agent, or expert witness representing or appearing in behalf of the party stating the actual time expended and the rate at which fees and other expenses were computed.

5 U.S.C. § 504(a)(2); *see* 17 C.F.R. §§ 201.41–.44.

The parties do not dispute that Applicants were prevailing parties in the underlying adversary adjudication and timely filed their application. However, the Division argues that Applicants have not met their burden of demonstrating they are eligible for an award under the statute. Moreover, according to the Division, Applicants did not incur any attorney fees. In the

alternative, the Division maintains that it has met its burden showing that its position was substantially justified.[5] I address each of these issues in turn.

Eligibility

To be eligible for recovery under EAJA, Applicants and their affiliates must have had a combined net worth of less than seven million dollars as of the date the OIP was filed. 5 U.S.C. § 504(b)(1)(B); 17 C.F.R. § 201.34(a)–(c), (f); *see Russo Secs., Inc.*, Exchange Act Release No. 42121, 1999 WL 1018116, at *1 (Nov. 10, 1999) (determining eligibility as of the date of the initiation of the underlying proceeding). Applicants bear the burden of establishing eligibility under EAJA. *Owner-Operator Indep. Drivers Ass'n v. Fed. Motor Carrier Safety Admin.*, 675 F.3d 1036, 1038 (7th Cir. 2012). The Division argues that Applicants have not met their burden of showing their net worth was below the threshold.

Applicants submitted net worth statements for themselves on Form D-A along with some supporting documentation. Dec. 15 Affirmation Exs. 1–2; Dec. 29 Br. Exs. 1–4. On February 12, 2017, EACM had no assets or liabilities. Dec. 29 Br. Ex. 1 at 93; *id.* Ex. 3 at 1 (checking account balance for EACM as of January 31, 2017). Between July 1, 2016, and September 30, 2016, EACA's net worth decreased from $1,209 to $1,048. *Id.* Ex. 4 at 1 (performance and capital summary for EACA); *see id.* Ex. 2 at 93 (Form D-A relying on the lower number and stating that EACA's net worth was $1,048).[6] Lathen has affirmed that EACA and EACM had "substantially the same net worth" as what is shown on the Form D-As on August 15, 2016, the date of the OIP. Dec. 15 Affirmation at 2. I have no reason to doubt Lathen's representation, nor has the Division given me any reason to do so. Applicants state that EACA's only asset was its investment in the Partnership, and that the performance summary shows its value at two points straddling the OIP date. Reply at 6. Applicants also state that EACM's only asset was its Bank of America checking account. *Id.* This makes sense. EACA is the general partner of the Partnership and EACM is the Partnership's investment adviser. *Donald F. ("Jay") Lathen, Jr.*, Admin. Proc. Rulings Release

---

[5] The parties also dispute how much of Applicants' claimed expenses can be recovered under EAJA. Since I find that the Division's position was substantially justified, I need not reach any matters concerning the amount of recovery.

[6] Because it makes no difference whether EACA's net worth was $1,209 or $1,048 when the OIP was filed, I too rely on the lower number in my sum of the net worth of Applicants and their affiliates.

No. 4723, 2017 SEC LEXIS 1005, at *2 (ALJ Mar. 31, 2017); Stipulated Findings of Fact (SFOF) ¶¶ 5, 7. They collected fees from the Partnership, but never held substantial assets. *See* Hr'g Tr. 120, 155. Their net worth as of the OIP date, even considering the net worth of Lathen and the Partnership, could not push Applicants above the eligibility threshold.

Although EACA and EACM are the only applicants in this EAJA case, I must also consider their affiliates and aggregate their net worth to determine eligibility. 17 C.F.R. § 201.34(f). Applicants concede that Lathen is their affiliate for EAJA purposes. Dec. 29 Br. at 3. Lathen initially submitted a net worth statement and over one thousand pages of supporting documentation demonstrating his net worth as of February 2017. Dec. 22 Affirmation Exs. 1–2; Jan. 17 Supp. Exs. Lathen later supplemented his financials with an affirmation, chart, and additional documents comparing his net worth on February 8, 2017, with his net worth as of the OIP date on August 15, 2016. Mar. 1 Affirmation. Based on this evidence, Lathen represents that as of the OIP date, his net worth was approximately $428,416. *Id.* at 2.[7] On March 26, 2018, Lathen submitted additional documentation at my direction estimating the value of his household furniture and his New York City apartment. Mar. 16 Supp. Affirmation. I did not require Lathen to get an appraisal on the apartment in the underlying proceeding, and I also decline to require an appraisal in this EAJA phase of the case. EAJA Tr. 87. Given the current listing price of Lathen's apartment and the offer he received, I am satisfied that the estimate of its value Lathen provided in his affirmations is reasonable. *See* Mar. 16 Supp. Affirmation Exs. 1–2; *see* Mar. 1 Affirmation Ex. 1 at 1. Adding the estimated value of the furniture to Lathen's net worth as of the OIP date increases it from $428,416 to approximately $487,671. Mar. 16 Supp. Affirmation Ex. 3. at 3.

The Division makes several arguments challenging the veracity of Lathen's net worth estimate, but I find none of them compelling. *See* Answer at 9–11; EAJA Tr. 85–89. Although it is true that Lathen initially provided his net worth as of the hearing date and merely estimated his net worth at the OIP date without providing supporting evidence, he cured that deficiency in his March 1, 2018, affirmation and exhibits. And contrary to the Division's assertions, I find that Lathen's documentation of the balance on his mortgages and credit cards is sufficient. *See* Answer at 10–11. In his March 1

---

[7] I have previously declined to redact net worth figures in this proceeding because they are "crucial to addressing eligibility" for relief under EAJA. *Donald F. ("Jay") Lathen, Jr.*, Admin. Proc. Rulings Release No. 5533, 2018 SEC LEXIS 266, at *2–3.

submission, Lathen compares the differences in the value of these line items as of the hearing date and as of the OIP date, and he provides explanations and supporting documentation. Mar. 1 Affirmation Ex. 1 at 2. I also have no issue with Lathen's explanation of his loans from friends and family. *See* Answer at 11. Again, Lathen has provided estimated balances of these loans as of the hearing date and the OIP date and has explained any differences. Mar. 1 Affirmation Ex. 1 at 2. His documentation of these loans was adequate; I see no reason why, for example, loans from friends and family cannot be documented by an email. Finally, the Division claims that Lathen's affidavits "are not trustworthy," but has given me no concrete reason to distrust them other than the fact that he initially failed to adequately document his net worth as of the OIP date. *See* EAJA Tr. 44. In any event, net worth is never more than an estimate, and I do not fault Lathen for being unable to provide every single piece of paper supporting his numbers. Unless Lathen's estimate is off by several hundred thousand dollars, which, given the robustness of Lathen's submissions, I do not see how it could be, Applicants and their affiliates are still below the statutory threshold.

Applicants argue that the Partnership is not their affiliate for EAJA purposes. Dec. 29 Br. at 3–4. The Division disagrees. Answer at 11–13. I do not necessarily have to resolve the question, because even if I treat the Partnership as an affiliate, the combined net worth of Applicants, Lathen, and the Partnership is below seven million dollars. However, I address it because it is central to the question discussed below of whether Applicants "incurred" fees.

The Commission's EAJA regulations provide the following:

> Any individual, corporation or other entity that directly or indirectly controls or owns a majority of the voting shares or other interest of the applicant, or any corporation or entity of which the applicant directly or indirectly owns or controls a majority of the voting shares or other interest, will be considered an affiliate for purposes of this subpart, unless the administrative law judge determines that such treatment would be unjust and contrary to the purposes of the Act in light of the actual relationship between the affiliated entities.

17 C.F.R. § 201.34(f).

EACA never invested any money in the Partnership. Hr'g Tr. 50–52; *see* Dec. 29 Br. Ex. 2 at 93 (Form D-A showing few assets). And EACM is the Partnership's investment adviser, not a shareholder or owner. SFOF ¶ 5.

Nonetheless, EACA holds all of the general partnership interest and directly controls the Partnership through the limited partnership agreement. According to the agreement, "[t]he management, operation and power to select and pursue the investment objectives of the Partnership shall be vested exclusively in [EACA] and/or [EACM]." Dec. 15 Affirmation Ex. 3 at 6. EACA has "the power, in the name of the Partnership, to carry out any and all of the objectives and powers of the Partnership." *Id.* And, "[t]he Limited Partners shall take no part in the conduct or control of the Partnership's business and shall have no authority or power to act for or bind the Partnership." *Id.* Because Applicants are solely in control of the Partnership's operations through EACA's interest as general partner, they are affiliates. *See* 17 C.F.R. § 201.34(f). The fact that the Partnership agreed to pay Applicants' legal fees further demonstrates the close connection between the three entities. All three entities were integral parts of Lathen's investment strategy, and it would be inappropriate to separate their interests from each other in this phase of the proceeding.

Applicants submitted balance sheets for the Partnership as of June 30, 2016, and September 30, 2016—in other words, shortly before and after the OIP date. Dec. 29 Br. Ex. 6. Applicants, relying on the larger June 30 number, state that the Partnership's net worth was $6,207,438 as of the OIP date. *Id.* Ex 5; *see id.* Ex. 6 at 2. The Division does not dispute Applicants' assertion. *See* Answer at 13; Reply at 4 n.1. Accordingly, Applicants' net worth as of the OIP date, when combined with the net worth of their affiliates, was approximately $6,696,157, which is below the seven million dollar statutory maximum.

The Division argues that Applicants and their affiliates are "perilously close" to the seven million dollar mark. Answer at 13. But Applicants and their affiliates are below the threshold when all is said and done. Applicants have met their burden.

Fees Incurred

Applicants must have also "incurred" fees and expenses in connection with the proceeding. 5 U.S.C. § 504(a)(1). The question I address here—one which has been debated by the circuit courts—is whether one is considered to have "incurred" fees if they were paid by a third party.

Applicants admit that the Partnership paid their legal fees and expenses in the underlying proceeding pursuant to the limited partnership agreement. Dec. 15 Affirmation at 2–3; *id.* Ex. 3 at 25; *id.* Ex. 4. On December 2, 2017, just days before this EAJA application was filed, the Partnership and Applicants signed an agreement memorializing their understanding that the

limited partnership agreement entitles the Partnership to receive all money awarded under a successful EAJA claim. *Id.* Ex. 4.

At first glance, it appears that Commission precedent dictates that Applicants did not incur fees. In *Montgomery*, 2001 WL 1618266, at *10, the Commission concluded that an individual applicant, Kirk Montgomery, did not incur any fees under EAJA when his legal expenses were paid by his employer, which was not a party to the proceeding but required by state law to reimburse Montgomery for his legal costs (had it not already paid them) because he prevailed in the proceeding. In coming to its decision, the Commission relied on two circuit court cases, *SEC v. Paisley*, 957 F.2d 1161 (4th Cir. 1992), and *SEC v. Comserv Corp.*, 908 F.2d 1407 (8th Cir. 1990). Understanding the reasoning of these cases is instructive.

In *Comserv*, Thomas Johnson prevailed against the Commission, but his legal fees were paid by his employer, Comserv, pursuant to a contractual agreement. *See* 908 F.2d at 1413. Comserv was also a party to the litigation, but did not prevail against the Commission. *Id.* at 1412–13. Because Johnson's legal fees were covered by his employer from the outset, the court held that he "was able to pursue his defense in the [Commission] action secure in the knowledge that he would incur no legal liability for attorneys' fees. To hold he 'incurred' such fees is to turn the word upside down." *Id.* at 1414–15. The court further explained that EAJA was enacted to diminish the deterrent effect of cost on litigating against unreasonable government positions, but when fees are paid by a third party, no deterrent exists. *Id.* at 1415. Finally, the court reasoned that its approach would prevent EAJA fees from being passed on to a third party that was ineligible under the net worth test. *Id.* at 1416.

In *Paisley*, the court denied the EAJA claim because the prevailing parties were required by state statute to be indemnified by their employer. *See* 957 F.2d at 1164. The court reasoned that since the litigants "were funded by an advance which by contract they need not refund if they prevailed in litigation" they "would not have been deterred had the EAJA not then existed." *Id.* The court concluded that "a claimant with a legally enforceable right for full indemnification of attorney fees from *a solvent third party* cannot be deemed to have incurred that expense for purposes of the EAJA." *Id.* (emphasis added).

However, *Montgomery* and the cases it relies on can be distinguished. In all of those cases, because an employer paid attorney fees, the litigants were not deterred from challenging the government's allegations, and EAJA's purpose was not served by an award of fees. Here, however, the Partnership's payment of attorney fees did not eliminate the deterrent effect. The

Partnership was not a third-party employer, but an affiliated entity with which Applicants had intertwined interests and a fiduciary relationship. And the Partnership's net worth is below the EAJA threshold. Applicants could not simply drain the Partnership's assets to defend this proceeding without considering the financial impact on the Partnership and their fiduciary duties. Applicants may still have been deterred from challenging the Division's allegations despite the fact that the Partnership was paying their attorney fees.

Moreover, the Partnership paid Applicants' attorney fees because it was the only entity among the group of affiliates (aside from perhaps Lathen) that had the resources to do so. Applicants did not choose to look elsewhere for financial assistance, but were defended by an affiliated entity that was equally part of the reason the Division brought the proceeding in the first place. If the Division had brought this proceeding against the Partnership as well, there would be no question that fees were incurred. It would be unfair to penalize Applicants and hold that they are ineligible under EAJA simply because the Division chose not to name the Partnership as a party. And it would be inappropriate, in my view, to aggregate Applicants' and the Partnership's net worth while simultaneously ruling that Applicants are ineligible because the Partnership paid their attorney fees. It is hard to separate Applicants' interests from those of the Partnership. I cannot make the Partnership a prevailing party in this case when it is not, but neither can I in good faith find that it is a disinterested "manifestly solvent third party." *Paisley*, 957 F.2d at 1164 (referring to The Boeing Company, Inc., which is firmly ensconced in the Fortune 50). And because the Partnership is below the net worth threshold, this is also not a case where we need fear that a fee award will go to an ineligible entity. *See Comserv*, 908 F.2d at 1416.

Finally, unlike in *Montgomery*, Applicants have entered into an agreement to pay over any EAJA award received to the Partnership. Recent circuit court decisions have explained that contingency-fee agreements satisfy the requirements of EAJA, because "litigants 'incur' fees under the EAJA when they have an express or implied legal obligation to pay over such an award to their legal representatives." *Turner v. Comm'r of Soc. Sec.*, 680 F.3d 721, 725 (6th Cir. 2012); *Murkeldove v. Astrue*, 635 F.3d 784, 791 (5th Cir. 2011) (holding that plaintiffs incur fees when they have the obligation, pursuant to a contingency-fee agreement, to provide the EAJA award to their attorneys pursuant to agreement); *Morrison v. Comm'r*, 565 F.3d 658, 662 (9th Cir. 2009) (interpreting "incur" in a fee-shifting statute nearly identical to EAJA to include "a contingent obligation to repay the fees in the event of their eventual recovery"). There is little difference, for example, between the agreement entered into by Applicants and the Partnership and the one that

the Fifth Circuit found sufficient in *Murkeldove*. There, the parties paid no fees to their attorneys but agreed to pay any EAJA recovery to their attorneys; here, Applicants agreed to pay any award to the Partnership, the entity that paid their attorney fees. *See Murkeldove*, 635 F.3d at 791. Put another way, by signing an agreement with the Partnership, Applicants assumed a contingent obligation to pay attorney fees, thus "incurring" them.

The Division maintains that because Applicants and the Partnership signed the repayment agreement only a few days before the filing of the EAJA application, it was a "last minute attempt" that shows Lathen and Applicants realized they were not eligible for an EAJA award. Answer at 15–16. But the Division points to no law that says that such an agreement must be signed before the proceeding begins and the case is litigated. A legal obligation to give the fee award to the Partnership now exists, thus preventing Applicants from receiving a windfall by pocketing the money. *See Turner*, 680 F.3d at 725. And in any event, Applicants argue that "[a]s fiduciaries of the [Partnership], [Applicants] could never conceivably retain such an award themselves," and that the agreement was created merely "to memorialize [Applicants'] undisputed obligation to return any EAJA award to the [Partnership]." Reply at 14. Applicants' logic is persuasive. Thus, at the very least, there was always an implied agreement that any EAJA award would belong to the Partnership. That implied legal obligation is sufficient. *Turner*, 680 F.3d at 725; *see Ed A. Wilson, Inc. v. Gen. Servs. Admin.*, 126 F.3d 1406, 1409 (Fed. Cir. 1997). In sum, even if Applicants did not directly incur attorney fees, this case is among "a limited amount of residual situations in which policy dictates allowing fees to further the goals of the EAJA." *Murkeldove*, 635 F.3d at 791.[8]

Substantial Justification

Because Applicants have established their eligibility, the burden shifts to the Division to establish that its position was substantially justified. 5

---

[8] Applicants support their position by citing several cases finding that fees were incurred when paid by an insurance company. *E.g.*, Reply at 11–14. But insurance cases are inapposite. As the Commission explained, someone who takes out an insurance policy "incur[s] legal fees insofar as [it] . . . paid for legal services in advance." *Montgomery*, 2001 WL 1618266, at *10 (quoting *Wilson*, 126 F.3d at 1410); *see also United States v. Thouvenot, Wade & Moerschen, Inc.*, 596 F.3d 378, 383–84 (7th Cir. 2010) ("insurance premiums are the fee that the insured pays for the insurance company's defense of his case"). Applicants paid nothing here.

U.S.C. § 504(a)(1); 17 C.F.R. § 201.35(a). Substantial justification means that the government's position was "justified to a degree that could satisfy a reasonable person" and had a "reasonable basis in law and fact." *Pierce v. Underwood*, 487 U.S. 552, 565–66 & n.2 (1988).[9] "The standard is met when 'one permissible view of the evidence leads to the conclusion that the government has shown a reasonable basis in fact and law for its position.'" *Rita C. Villa*, Exchange Act Release No. 42502, 2000 WL 300264, at *4 n.9 (Mar. 8, 2000) (quoting *Jackson v. Bowen*, 807 F.2d 127, 130 (8th Cir. 1986)). "If the Division's case is 'justified to a degree that could satisfy a reasonable person,' then no fees are to be awarded under the EAJA." *Michael Flanagan*, Securities Act Release No. 8437, 2004 WL 1538526, at *4 (July 7, 2004) (quoting *Pierce*, 487 U.S. at 565). The outcome of the underlying case is not dispositive; instead, an "independent evaluation [must be conducted] through an EAJA perspective." *Richard J. Adams*, Exchange Act Release No. 48146, 2003 WL 21539570, at *5 & n.14 (July 9, 2003) (alteration in original) (quoting *FEC v. Rose*, 806 F.2d 1081, 1087 (D.C. Cir. 1986)).

The Commission has explained, "The Supreme Court has stated that '. . . EAJA . . . favors treating a case as an inclusive whole, rather than as atomized line-items'" and "'only one threshold determination for the entire civil action is to be made.'" *Flanagan*, 2004 WL 1538526 at *4 (quoting *Comm'r v. Jean*, 496 U.S. 154, 159, 161–62 (1990)). Therefore, "we consider whether the Division's case *as a whole* was substantially justified." *Id.* (emphasis added); *see also Saysana v. Gillen*, 614 F.3d 1, 5 (1st Cir. 2010) ("in evaluating the Government's position, we must arrive at one conclusion that simultaneously encompasses and accommodates the entire civil action" (internal quotation marks omitted)).[10]

---

[9] Applicants suggest that substantial justification requires "more than reasonableness," Reply at 2, but that test was rejected by the Supreme Court. *See Pierce*, 487 U.S. at 566–68.

[10] *Flanagan* did not expressly rule on a case such as this one, which involves two allegations predicated on distinct factual findings and legal arguments, and not just statutorily separate allegations revolving around a single legal theory and a core set of facts. *See Flanagan*, 2004 WL 1538526, at *2–3; *see also Gatimi v. Holder*, 606 F.3d 344, 350 (7th Cir. 2010) (observing that the Supreme Court in *Jean* did not really address "whether allocation is permissible under" EAJA, and noting that the issue "merits further consideration"). Some courts have considered whether there are situations that might justify a more compartmentalized approach to substantial justification. For example, in *SEC v. Morelli*, No. 91-cv-3874, 1995 WL 9387, at *8 (S.D.N.Y. Jan. 11, 1995), the district court found that the Division's

(continued...)

1. The Division's fraud allegations were substantially justified.

Applicants' alleged fraud presented a very close case. There were many issues at play, each with multiple subparts. Further, the proceeding was marked by novel legal issues. In the first instance, I had to determine what duty, if any, Respondents had to bond issuers, not, as is more commonly litigated, the duty they owed to investors. Initial Decision at 35–38. I also examined whether the redemption of a bond was a sale. *Id.* at 40–41. And significantly, the case revolved around the legal legitimacy of joint tenancies that Lathen entered into with terminally ill participants. As I discussed at length, New York law is unsettled on the question of their validity. *Id.* at 45–57.

Many courts have held that "[u]ncertainty in the law arising from conflicting authority or the novelty of the question weighs in the government's favor when analyzing the reasonableness of the government's litigation position." *Gatimi*, 606 F.3d at 348 (quoting *Kholyavskiy v. Holder*, 561 F.3d 689, 691 (7th Cir. 2009)). Although "there is no per se rule that EAJA fees cannot be awarded where the government's litigation position contains an issue of first impression," *Gutierrez v. Barnhart*, 274 F.3d 1255, 1261 (9th Cir. 2001), it does contribute to a finding of substantial justification. *Saysana*, 614 F.3d at 5; *Gatimi*, 606 F.3d at 348; *see Timms v. United States*, 742 F.2d 489, 492 (9th Cir. 1984) (holding that the government may carry its "burden by showing its position advanced a novel but credible extension or interpretation of the law" (internal quotation marks omitted)). The novelty of the issues raised in this case therefore weighs in the Division's favor, even though it is not dispositive.

Despite my lengthy analysis of the joint tenancy issue, in the end my decision hinged on one issue: scienter. And there are two reasonable ways of looking at Lathen's state of mind. I found that once Lathen started disclosing material information to issuers, namely, that he was a surviving joint tenant with a right to redeem the bonds, he had a duty to ensure that his disclosures were not misleading or otherwise incorrect. Initial Decision at 38. I also found that Lathen knew he was not providing issuers with all the information he had, but that he legitimately believed, based on the advice he received from

---

allegation of insider trading against the defendant because of his own trades was justified, but that its similar allegations against him because of other people's trades was not. However, I need not decide whether considering the Division's fraud and custody rule allegations separately is appropriate. As I find below, each was substantially justified, and therefore, whichever way I look at it, the Division's position as a whole was substantially justified.

his attorneys, that he did not need to. *Id.* at 60. Yet he also knew there was a question mark hovering over the sufficiency of his disclosures. Although one attorney, Robert Flanders, told Lathen he did not need to disclose any more information, another attorney, Margaret Farrell, warned him that some iterations of his participant agreement may not have created valid joint tenancies. *See* Hr'g Tr. 2037, 2621–25.

The Division argued that Lathen was knowing, reckless, or negligent in failing to disclose material information to issuers, that is, his side agreements with participants and with the Partnership. I held that a preponderance of the evidence tipped in Lathen's favor, and that Respondents did not commit fraud. As I discussed at length, there was a good argument to be made that most of Lathen's joint tenancies were valid and that his reading of his contracts with the issuers was technically correct. Initial Decision at 57. The evidence showed that not only did Lathen believe he had found a legal loophole, but that several attorneys agreed with him. Hr'g Tr. 2032–42, 2444–52 (testimony of Flanders and Robert Grundstein). And many issuers paid Lathen even after he disclosed the side agreements to them, at least suggesting that they too believed he had found a valid loophole. Hr'g Tr. 1676, 3407–08; *see* DX 481; RX 1970. On this record, I did not think the Division had met its burden of demonstrating that Lathen acted with scienter.

But a reasonable person could find that Lathen's failure to disclose the side agreements was reckless. Lathen knew that joint tenancy law was unsettled, and that his interpretation was a novel one. *See, e.g.*, DX 369 at 25–26 (the Partnership's private placement memorandum acknowledged that issuers may take a different view of Lathen's investment strategy and that regulators could frustrate it); DX 570 at 3–4; DX 571 at 2; Hr'g Tr. 782–91 (Goldman Sachs told Lathen that his status as a joint tenant was "not legally recognizable"); Hr'g Tr. 1206–10 (GE Capital Corp. told Lathen that his account structure negated beneficial ownership of the joint account). He knew that the definition of "beneficial owner" in the contracts he signed with issuers was uncertain. *See, e.g.*, DX 558 at 2; DX 559 at 1–3 (GE Capital's refusal letters argued that participants' lack of beneficial ownership was fatal to Lathen's request regardless of the questions about the joint tenancies). Lathen was aware that legal action had been taken against others who had attempted similar survivor's option investment strategies—even though he believed his strategy was different. Hr'g Tr. 572, 704 (Lathen knew about the cases brought against Joseph Caramadre and Benjamin Staples). And some of his lawyers warned him of risks in his investment model, even if they did not expressly tell him to stop. Hr'g Tr. 2620–25. One could reasonably maintain that by redeeming the bonds without disclosure of the side

agreements, Lathen acted in reckless disregard of the possibility that some of his joint tenancies were invalid and that his disclosures were therefore misleading. Particularly after Farrell told him that his joint tenancies established under the investment management agreement (IMA) were questionable, it is reasonable to conclude that Lathen should not have continued to request redemptions from those accounts without providing the IMA and the participant agreements. This is certainly one permissible view of the evidence. *See Villa*, 2000 WL 300264, at *4 n.9.

The Division's allegation that Lathen was negligent was reasonable for the same reasons. When I found that Lathen was not negligent, it was largely because the Division failed to present appropriate evidence of the standard of care to which Lathen should be held. Initial Decision at 61–62. Although the Division rested its case on Lathen having scienter, it is plausible from the facts in the record to determine that Lathen acted negligently. For the reasons explained above, it is possible that all of Lathen's redemption requests demonstrated negligence. But particularly after he was aware that there were questions about the IMA's effect on the validity of the joint accounts, he could have exercised greater care to avoid potentially material misstatements or omissions by providing additional disclosure when requesting redemption of accounts established under the IMA or he could have stopped redeeming them.

In fact, FINRA found one of Lathen's brokers, C.L. King & Associates, negligent based on a similar record. In particular, FINRA noted that C.L. King made negligent misrepresentations to issuers by submitting Lathen's redemption requests that labeled him as a joint tenant when in fact no valid joint tenancy had been created under New York law. *Dep't of Enforcement v. C.L. King & Assocs., Inc.*, No. 2014040476901, 2017 FINRA Discip. LEXIS 33, at *45–48, *61–62 (FINRA OHO Sept. 6, 2017). Although I interpreted New York law differently, no New York court has ruled on the matter. It is by no means a certain thing that I am correct and FINRA is wrong. Given the substantial uncertainty on the issue of validity, one could reasonably argue that Lathen was at least negligent—if not reckless—in making redemption requests of questionable legality without disclosure of the side agreements.

I find Applicants' arguments against substantial justification unconvincing. *See* Reply at 16–23. Applicants point to evidence in their favor—and indeed, I agreed with them in my initial decision—but they ignore other less favorable aspects of the record. Significantly, Applicants do not address the possibility that Lathen could have acted recklessly or negligently even if he was advised by attorneys, treated participants and investors fairly, and cooperated with the Division's investigation. *See id.* at 18–20. They note only that the Division failed to satisfy its burden to provide the relevant

standard of care for negligence. *Id.* at 20 n.9. Applicants further argue that the Division's position on the definition of beneficial ownership was "plainly refuted by the [issuers'] written contracts," *id.* at 21, but I am not so sure. In my initial decision, I found that at least some of the contracts were ambiguous, *see* Initial Decision at 42–44. In any event, the Division's position on the meaning of beneficial ownership was not unreasonable. Finally, although Applicants correctly point out that my inclination was that many of Lathen's documents did not interfere with the creation of valid joint tenancies, they concede that with respect to other documents "the Division's joint tenancy argument was at least plausible." Reply at 22. Indeed, New York law was and is unsettled on the joint tenancy issue, which favors a finding that the Division's position on the joint tenancies was reasonable.

However, I agree with Applicants inasmuch as I do not think it is possible to maintain that Lathen knowingly defrauded issuers. *See id.* at 20 (declaring "hopelessly unjustified" the notion that Lathen "merely maintained an outward veneer of . . . legality . . . while secretly knowing that his conduct was wrongful"). For that to have been the case, Lathen would need to have *known* his joint tenancies were invalid and that he and/or the participants were not beneficial owners of the joint accounts. But such knowledge would have been impossible given that New York law is unsettled on the matter and the contracts were ambiguous at best. Lathen knew that he was not providing issuers with everything he had, but he believed he was providing them with everything they legally needed to know. There is no way Lathen could have known with certainty that his disclosures were objectively deficient.

Thus, the Division's allegations of recklessness and negligence were substantially justified; its allegations of knowing fraud were not. Nonetheless, when looking at the matter as a whole, which I must, the Division's allegations that Respondents committed some degree of fraud or were negligent were substantially justified. *See Roanoke River Basin Ass'n v. Hudson*, 991 F.2d 132, 139 (4th Cir. 1993) (rejecting "the view that *any* unreasonable position taken by the government in the course of litigation automatically opens the door to an EAJA fee award"); *Hanover Potato Prod., Inc. v. Shalala*, 989 F.2d 123, 131 (3d Cir. 1993) (not "every argument made by an administrative agency must be substantially justified," but they must all be evaluated to "determine whether, *as a whole*, the Government's position was substantially justified").

2. The Division's allegations of custody rule violations were substantially justified.

The second allegation in the underlying case was that EACM violated the custody rule because it failed to hold Lathen and the participants' joint accounts, which the Division claimed were the assets of EACM's client, the Partnership, in the Partnership's name or in its own name as a trustee of the Partnership. The Division argued that the joint accounts belonged to the Partnership—and not to Lathen and the participants—for several reasons: (1) EACM's Forms ADV stated that the Partnership had custody of them; (2) the IMA gave the Partnership custody; (3) later, the discretionary line agreement (DLA) and profit sharing agreement (PSA) also gave the Partnership custody; and (4) even if the DLA and PSA did not grant custody of the joint accounts to the Partnership, the promissory note associated with the DLA was a security and should have been kept by a custodian. I rejected each one of the Division's arguments. Here, however, I must resolve whether the Division's allegations of custody rule violations were, on the whole, substantially justified.

There is no question that the Division's second argument—that the IMA gave the Partnership a beneficial interest in the joint accounts—was reasonable. On its face, the IMA states that "[a]ll other attributes of the beneficial ownership of the [survivor's option] Investments shall be and remain in [the] Partnership." DX 191 at 2. This language appears to give the Partnership a beneficial interest. I found that the IMA should not be taken at face value because it was otherwise an ambiguous document, and to interpret it as giving ownership of the joint accounts to the Partnership would be contrary to Respondents' intent. Initial Decision at 64–65. Moreover, functionally, the Partnership had no access to the accounts, and the statutory basis of the custody rule did not support a reading of it that would usurp client judgment on how assets should be classified. *Id.* However, it is undeniable that on its face, the Division's reading of the IMA was reasonable and substantially justified.

I am less sure that the Division's other three arguments were reasonable, but I am inclined to find that they were. Unlike the IMA, the DLA and PSA expressly set up a structure in which the Partnership had no ownership of the joint accounts, but only lent money to Lathen to establish them and was entitled to profits from them. DX 190 at 2; DX 72 at 2. The Division argued that nonetheless EACM violated the custody rule because Lathen, who controlled the adviser EACM, should not be allowed to loan assets to himself in an individual capacity to get around the custody rule. The Division was basically arguing that for policy reasons, the custody rule should be extended to cover a new situation. Nonetheless, I am inclined to

find its position reasonable given that the government may carry its "burden by showing its position advanced a novel but credible extension or interpretation of the law." *Timms*, 742 F.2d at 492 (internal quotation marks omitted).

The Division also argued that regardless of the language of the IMA, DLA, and PSA, the Partnership still had custody of the joint accounts because EACM's Forms ADV said it did. I found that Respondents could not be held to their statements in the Forms ADV if they mischaracterized the actual legal arrangement. Initial Decision at 66. If the joint accounts were not actually the Partnership's funds, it did not matter if Lathen said they were. Because the Forms ADV on their face supported a custody rule violation, however, it would seem like the Division's decision to bring the allegations it did was supportable—at least at the outset.

I found that the promissory note was not a security because anyone who looked at the piece of paper could see that it evidenced a standard loan and was not a profit-earning instrument. Initial Decision at 68–70. But perhaps it is not entirely unreasonable for one to maintain that it was a security, given that it was created to support the DLA and PSA.

Yet even if several of the arguments made regarding the custody rule were not reasonable, the Division's allegation that the IMA created a structure that violated the custody rule was reasonable. The IMA controlled many of the joint accounts at issue in the case. Initial Decision at 11 (Lathen used the IMA for more than a year-and-a-half). That is enough to say that on balance, the Division was, on the whole, substantially justified in alleging a custody rule violation.

Order

Based on my independent evaluation of the administrative record as a whole, I find that the Division of Enforcement's position was substantially justified. Accordingly, Applicants Eden Arc Capital Management, LLC, and Eden Arc Capital Advisors, LLC, are not entitled to recover fees and costs under the Equal Access to Justice Act, and their application is DENIED.

This initial decision shall become effective in accordance with and subject to the provisions of Section 201.57 of the Commission's rules pertaining to the Equal Access to Justice Act, 17 C.F.R. § 201.57. Under that rule, an applicant or Division counsel may file a petition for review of this initial decision within twenty-one days after service of the decision. 17 C.F.R. §§ 201.57, .410(b). A motion to correct a manifest error of fact may be filed within ten days of the initial decision. *See* 17 C.F.R. §§ 201.111(h), .410(b). If

a motion to correct a manifest error of fact is filed, then an applicant or Division counsel shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion. *See* 17 C.F.R. § 201.410(b).

If neither an applicant nor Division counsel seek review and the Commission does not take review on its own initiative, this initial decision "shall become a final decision of the Commission" on October 1, 2018. 17 C.F.R. §§ 201.57, .160(a).

_____

Jason S. Patil
Administrative Law Judge