

## [Securities Regulation Daily Wrap Up, ENFORCEMENT—10<sup>th</sup> Cir.: Sanctions for secret commission scheme affirmed, \(Aug. 14, 2019\)](#)

Securities Regulation Daily Wrap Up

[Click to open document in a browser](#)

By [Rodney F. Tonkovic, J.D.](#)

The Commission did not abuse its discretion in finding that an adviser's CEO violated the securities laws by secretly routing trades to a broker-dealer branch office he once owned.

A Tenth Circuit panel affirmed the SEC's sanctioning of the CEO of an investment adviser for failing to disclose a conflict of interest. In this case, the CEO routed trades to a broker-dealer branch office he once owned in order to generate commissions so the current owner could pay what he owed to the CEO. The panel concluded that the Commission reasonably found that the CEO knowingly violated the securities laws by failing to disclose this three-year conflict of interest and that he aided and abetted the adviser's related violations. The Commission also did not err in imposing harsher sanctions than were imposed by the administrative law judge ([Malouf v. SEC](#), August 13, 2019, Bacharach, R.).

**Commissions scheme.** In 2007, Dennis Malouf sold a branch of Raymond James Financial Services, which provided broker-dealer services. This was done at the urging of Raymond James, which was concerned about a conflict of interest between Malouf's ownership of the branch office and his simultaneously-held position as CEO of investment adviser UASNM, Inc. Malouf accordingly sold his Raymond James branch to Maurice Lamonde for \$1.1 million, to be paid in installments based on the branch's collection of securities-related fees. Malouf then helpfully routed bond trades on behalf of his UASNM clients to the Raymond James branch, eventually allowing Lamonde to collect enough in commissions to pay Malouf.

According to the SEC, however, Malouf disclosed neither his agreement with Lamonde nor the resulting conflict of interest to UASNM or its clients. At the same time, Malouf failed to seek competing bids for the trades, in violation of UASNM's compliance procedures. As a result, UASNM failed to disclose not only Malouf's conflict of interest but also touted its impartiality, boasting that it was not receiving commissions or fees from the Raymond James branch. UASNM disclosed the conflict of interest after an outside consultant discovered it.

**SEC sanctions.** The Commission brought an [enforcement proceeding](#) against Malouf (UASNM [settled](#) its related proceeding), and an administrative law judge found that his actions had violated the antifraud provisions of the federal securities laws and that he had aided and abetted UASNM's violations. In addition to a cease-and-desist order, the ALJ imposed associational and officer/director bars and required payment of a \$75,000 civil penalty, while declining to impose disgorgement. On appeal, the [SEC agreed](#), but added a lifetime industry bar and ordered disgorgement of \$562,001.26 plus prejudgment interest.

**Appeal.** On appeal, Malouf argued that: (1) the appointment of his administrative law judge violated the Constitution's Appointments Clause; (2) the SEC misinterpreted the securities laws; (3) the SEC's findings lacked substantial evidence; and (4) the sanctions should be vacated. Regarding the first, the court concluded that Malouf forfeited his Appointments Clause challenge by failing to present it during the SEC proceedings.

Malouf maintained that he satisfied an exception to the exhaustion requirement because it would have been futile to raise the challenge before the SEC and because the law changed after the Commission had ruled. The court rejected the futility argument, stating that, at that time (September 2015, immediately before [Lucia](#)), the Commission would not necessarily have rejected an Appointments Clause challenge. And, while the [Tenth Circuit](#) and [U.S. Supreme Court](#) later held that SEC administrative law judges are inferior officers subject to the Appointments Clause, the court said that neither case changed the law but instead merely applied the reasoning behind the Supreme Court's 1991 opinion in *Freytag*.

**SEC findings were reasonable.** The court then went on to find that the SEC's findings were reasonable. First, the Commission reasonably found that Malouf violated that antifraud provisions of the securities laws by failing to correct material misstatements. Here, Malouf contended that liability could not be based on his failure to correct UASNM's misstatements because the failure to correct was inseparable from the misstatements themselves. The court rejected this argument based on [Lorenzo v. SEC](#), which expressly held that a person could incur liability under the antifraud provisions for conduct involving another person's false or misleading statement. Continuing, the court determined that substantial evidence showed that Malouf knowingly failed to correct misstatements or to disclose his conflict of interest.

The court similarly found that Malouf violated the Investment Advisers Act and aided and abetted UASNM's violations of the Act. The court noted that the language in the Advisers Act provisions is nearly identical to the language in the Exchange and Securities Acts and applied the same reasoning. In addition, the court concluded that the Commission's finding that Malouf violated his duty of best execution was supported by substantial evidence. According to the court, Malouf's duty to his clients was his own, and not that of his firm or chief compliance officer, and he conceded that he had routinely failed to seek competing bids before routing trades through the Raymond James branch, with which he had an undisclosed financial relationship.

**No error in sanctions.** Finally, the Commission did not abuse its discretion in imposing a lifetime bar or in ordering disgorgement. The court noted that the Commission reasonable considered Malouf's failure to recognize his own wrongdoing and the fact that he waited almost three years before disclosing his conflict of interest. Regarding the disgorgement, the ALJ considered the funds received from Lamonde as legal profits not subject to disgorgement, but the Commission disagreed, concluding that the payments were the result of violations of the securities laws. The court agreed that the Commission reasonable concluded that all of Lamonde's payments to Malouf were traceable to his misconduct and needed to be disgorged.

The case is [No. 16-9546](#).

Attorneys: Kenneth Berg (Ulmer & Berne LLP) for Dennis J. Malouf. Daniel J. Aguilar, U.S. Department of Justice, for the SEC.

LitigationEnforcement: BrokerDealers Enforcement FraudManipulation InvestmentAdvisers ColoradoNews KansasNews NewMexicoNews OklahomaNews UtahNews WyomingNews