SCHEDULED FOR ORAL ARGUMENT ON FEBRUARY 6, 2012

In the

United States Court of Appeals

for the

District of Columbia Circuit

11-1082

DAN RAPOPORT,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR REVIEW OF AN ORDER OF THE SECURITIES AND EXCHANGE COMMISSION IN CASE NO. SEC-REL34-63744

FINAL BRIEF FOR PETITIONER

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CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES

Pursuant to D.C. Cir. Rule 28(a)(1), Petitioner Dan Rapoport ("Rapoport") files this Certificate as Parties, Rulings and Related Cases as follows:

A. Parties

The parties to this case are Rapoport and the Securities and Exchange Commission ("SEC" or the "Commission"). The December 8, 2008 Order Instituting Proceedings against Rapoport ("OIP") also named as a respondent, in addition to Rapoport: CentreInvest, Inc. ("CI-New York"), OOO CentreInvest Securities ("CI-Moscow"), Vladimir Chekholko ("Chekholko"), William Herlyn ("Herlyn"), and Svyatoslav Yenin ("Yenin") (together with Rapoport, the "OIP Respondents").

B. Rulings Under Review

Rapoport's Petition arises from the Commission's Decision dated January 20, 2011 (the "Decision") that denied Rapoport's Motion to Set Aside [as to him] the Order Making Findings and Imposing Sanctions by Default as to CentreInvest, Inc., Dan Rapoport, and Svyatoslav Yenin dated July 31, 2009 (the "Default Order").

C. Related Cases

There are no pending related cases of which counsel is aware, including cases brought by the other OIP Respondents.

STATEMENT REGARDING ORAL ARGUMENT

In a June 21, 2011 order, the Court scheduled oral argument for October 20, 2011. On June 29, 2011, the Court granted Rapoport's unopposed motion to stay the briefing schedule pending mediation, removed the case from the October 20, 2011 oral argument calendar, and set a revised briefing schedule. Pursuant to the revised schedule, final briefs are due December 19, 2011. The Court has scheduled oral argument for February 6, 2012.

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OTHER AUTHORITIES

GLOSSARY

Term:	**Defined Herein As**:
ALJ	Administrative Law Judge
Adopting Release	The August 15, 1989 Adopting Release for Rule 15a-6 titled "Registration Requirements for Foreign Broker-Dealers"
Commission or SEC	Respondent Securities and Exchange Commission
Chekholko	OIP Respondent Vladimir Chekholko
CI-Moscow	OOO CentreInvest Securities, Rapoport's Moscow-based employer
CI-New York	CentreInvest, Inc., CI-Moscow's affiliated, registered New York broker dealer
Decision	The SEC Order denying Rapoport's Motion to Set Aside the Default Order dated January 21, 2011
Division	SEC's Division of Enforcement
Default Order	The Order Making Findings and Imposing Sanctions by Default as to CentreInvest, Inc., Dan Rapoport, and Svyatoslav Yenin dated July 31, 2009
FINOP	Financial and Operations Principal
Herlyn	OIP Respondent William Herlyn
OIP	The SEC Order Instituting Proceedings dated December 8, 2008
OIP Respondents	Rapoport; CI-Moscow; CI-New York; Chekholko; Herlyn; and Yenin
Proposed Amendment	The SEC's July 2008 Proposed Rule on Exemption of Certain Foreign Broker

	Dealers
Rapoport	Petitioner Dan Rapoport
Rule	SEC Rule 15a-6
Section 15(a)	Section 15(a) of the Securities and Exchange Act of 1934
Yenin	OIP Respondent Svyatoslav Yenin

JURISDICTIONAL STATEMENT

This Court has jurisdiction pursuant to 15 U.S.C. § 78y, which provides that "[a] person aggrieved by a final order of the Commission entered pursuant to this title [15 U.S.C. §§ 78a et seq.] may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit . . . " 15 U.S.C. § 78y(a)(1).

STATEMENT OF ISSUES

1. Did the Commission abuse its discretion when, in denying Rapoport's motion to set aside the Default Order, it deliberately disregarded two of the three factors that must be considered when determining whether there is "good cause" to set aside an order of default, including (i) the merit of Rapoport's defenses and (ii) the prejudice to the Commission's Division of Enforcement?
2. Did the Commission abuse its discretion by imposing sanctions by default against Rapoport that: (i) are attributable to three years (2003-2005) for which there are no allegations (or facts) to support a conclusion that Rapoport violated the SEC's registration requirements; (ii) include "second-tier" penalties totaling $315,000, where there are no allegations (or facts) to support the required finding that Rapoport acted with a "mental state embracing intent to deceive, manipulate, or defraud," and where Rapoport is alleged to have violated an arcane registration requirement for foreign broker-dealers that the Commission criticized, and proposed eliminating, in July 2008.

STATUTES

The relevant statutory provisions at issue in this case, are attached in an Addendum pursuant to Circuit Rule 28(a)(5).

STATEMENT OF THE FACTS

CI-Moscow and CI-New York

In 1996, CI-Moscow, a Moscow-based broker-dealer, hired Rapoport to work in their Moscow office. JA 515 (¶ 2). In or about 1997, CI-Moscow established CI-New York as a registered U.S. broker-dealer affiliate. (*Id*.) CI-New York was, from June 23, 1998 through October 2, 2008, a registered broker-dealer organized under New York law with its principal place of business in New York, New York. JA 27 (¶ 3). Part of CI-New York's business was to solicit U.S. investors to purchase Russian equity securities using research provided by CI-Moscow, with the trades in those securities executed by, and other administrative functions performed by, CI-Moscow. JA 515-16 (¶¶ 2-5); JA 88-89 (¶¶ 52-55). After establishing the New York office, CI-Moscow and CI-New York obtained legal opinions stating that CI-New York's relationship with CI-Moscow with respect to soliciting investors and executing trades was in accordance with U.S. law. JA 515-16 (¶¶ 3, 5). Each year from 1999-2007, CI-New York provided the Commission with Form X-17A-5 reports that openly disclosed the relationship between CI-New York and CI-Moscow: that CI-New York was "an introducing broker with respect to domestic and certain foreign securities transactions and clears Russian securities transactions through facilities provided by [CI-Moscow]." JA 472 (n.7); JA 515(¶ 3).

Rapoport worked for CI-New York from approximately December 1999 through December 2001, during which time he was registered and licensed with the Commission. JA 515 (¶ 4). From approximately September 2003 through February 2008 (when Rapoport was terminated by CI-Moscow), Rapoport was a managing director and employee of CI-Moscow, responsible for equity research, trading and sales. JA 516-17 (¶¶ 7, 8, 11). During that period of time, Rapoport reported to Igor Tsukanov (President and CEO of CI-Moscow), and Karen Antonyan (CFO of CI-Moscow). (*Id*.)

The OIP

On December 8, 2008, after nine years (1999-2007) of CI-New York disclosing its relationship with CI-Moscow to the Commission on an annual basis, the Division filed the OIP alleging that the relationship between CI-New York and CI-Moscow violated the Commission's registration requirements. The OIP alleged that CI-New York and certain of its employees (Chekholko, Herlyn, and Yenin) violated of multiple SEC rules and regulations (JA 30-32, at ¶¶ 29-36), and that CI-Moscow and its employee (Rapoport) violated a single rule: Section 15(a) of the Exchange Act.

With respect to Rapoport, the OIP alleged generally that "from about 2003 until at least November 2007, CI-Moscow and the head of its brokerage operations, Rapoport, directly and indirectly solicited investors in the United States to

purchase and sell thinly-traded stocks of Russian companies . . . without registering as broker-dealers, as required by Section 15(a) of the Exchange Act, or meeting the requirements for an exemption from registration for foreign broker-dealers under Exchange Act Rule 15a-6(a)." JA 28 (¶ 9). The OIP did not allege a single "direct" solicitation of any U.S. investor by Rapoport. The OIP generally alleged that CI-New York and its employees (Yenin, Chekholko, and Herlyn) solicited investors "under Rapoport's direction" (JA 28, ¶ 10), but deliberately failed to allege that Rapoport – as opposed to his employer, CI-Moscow – "controlled" CI-New York in the years 2003, 2004 or 2005. JA 29 (¶ 17).

The OIP did not allege that Rapoport defrauded or misled investors, or that Rapoport misrepresented or omitted facts to investors. The OIP did not allege that Rapoport caused investors to suffer losses or harm of any kind. Nor did the OIP allege that any of the sophisticated U.S. investors who communicated with Rapoport or other CI-Moscow employees filed a single complaint about the conduct of Rapoport, CI-New York, or CI-Moscow.

Registration Requirements For Foreign Broker-Dealers

The sole allegation against Rapoport in the OIP is that Rapoport was required to register with the Commission but failed to do so, thereby violating Section 15(a) of the Securities and Exchange Act, 15 U.S.C. § 78o, ("Section 15(a)".) With respect to foreign broker-dealers, however, Section 15(a) is subject

to Rule 15a-6, 17 C.F.R. § 240.15a-6, (the "Rule") which makes it completely lawful for *unregistered* foreign broker-dealers (and associated persons) to communicate with U.S. investors – and even to solicit them to purchase foreign securities directly – under a range of different circumstances. JA 735-37; JA 821-59. As described by the Commission, Rule 15a-6:

> contains exemptions from broker-dealer registration for nondirect contacts through unsolicited transactions and the distribution of research reports, and it allows for direct contacts with certain U.S. institutional investors through intermediaries and with certain other defined classes of persons without intermediaries . . .

JA 833.

The Rule 15a-6 exceptions – which are the *de facto* registration requirements for *foreign* broker-dealers[1] – are fact-specific, subjective and extraordinarily complex. Rule 15a-6's Adopting Release alone spans 39 pages, contains 218 substantive footnotes, and incorporates several "interpretative statements" by Commission. JA 821-59. While the OIP makes a generic allegation that Rapoport failed to qualify for any of the Rule 15a-6 exemptions (JA 26 ¶ 1; JA 30 ¶¶ 26, 28), it does not allege how or why Rapoport's conduct failed to meet the exemptions, or specifically address any of the fact-specific exemptions.

[1] The August 15, 1989 Adopting Release for Rule 15a-6 (the "Adopting Release") is titled "Registration Requirements for Foreign Broker-Dealers." JA 821-59. *See also* SEC Release No. 34-40594, 1998 SEC LEXIS 2401, at *6 ("offshore firms can often avoid registering as broker-dealers in the United States if they . . . comply with the requirements of Rule 15a-6 under the Exchange Act".)

In July 2008 – five months *before* the Division filed the OIP and almost a full year *after* the Division commenced its investigation into the conduct alleged in the OIP[2] – the Commission proposed changes to Rule 15a-6 (the "Proposed Amendment") in response to criticism that the Rule was "impractical," "impos[ed] unnecessary operational and compliance burdens," and was incompatible with the "demand for foreign investments by U.S. investors, coupled with the continuing internationalization and interconnection among local securities markets and market intermediaries." *Id.*[3] Although the Proposed Amendment would have eliminated virtually all of the "operational and compliance" burdens that form the basis for the allegations in the OIP (JA 787), the OIP makes no mention of the Proposed Amendment that the Commission announced six months earlier. The Commission has taken no further action with respect to the Proposed Amendment since December 2008.

The Default Order

Instead of serving Rapoport with the OIP in Moscow, Russia, where he resides, the Division sought and obtained an order from the ALJ on February 5,

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2 JA 606

3 *See also* Exchange Act Release No. 58047, "Proposed Rule on Exemption of Certain Foreign Broker Dealers" (JA 767-816); Speech by SEC Staff (Erik R. Sirri) dated June 25, 2008. JA 818-20.

2009 that deemed service on Rapoport effective by virtue of service on Rapoport's former U.S. counsel, Richard Kraut ("Kraut"). JA 66-70; JA 116-20.[4]

Kraut had not been authorized to accept service by Rapoport, and had been retained by Rapoport for limited purposes. JA 117; JA 120. Rapoport never met with Kraut in person, and had a limited number of communications with Kraut. JA 518 (¶ 13). In the motion opposing service on Rapoport through him, Kraut represented that "he does not appear generally and, in fact, represents that he understands that his limited representation of [Rapoport] may terminate following decision of this motion." JA 72 (n.2).

Nonetheless, the ALJ concluded that service on Rapoport's limited-purpose U.S. counsel was sufficient because of, among other things, the "difficulty in serving persons in Russia," and as a result of Russia's "failure to follow its obligations under the Hague Convention." JA 118-19.[5] Kraut withdrew as counsel for Rapoport on February 12, 2009, effective February 5, 2009. JA 124-33.

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[4] The ALJ initially ordered service on Rapoport through his U.S. counsel in a December 31, 2008 Order (JA 66-70) without considering Rapoport's opposition to the Division's motion, which was filed (and served on the Commission) by Rapoport on December 23, 2008. JA 630. The ALJ allowed Rapoport to file an additional submission on January 27, 2009, and then denied Rapoport's motion for reconsideration on February 5, 2009. JA 116-20.

[5] As such, the Division never served Rapoport in accordance with the Commission's rules regarding personal service on foreign respondents, which require that notice of a proceeding may by given "by any method . . . reasonably calculated to give notice, *provided that the method of service used is not prohibited by the law of the foreign country*. *See* SEC Rule 141(a)(2)(iv) (emphasis added);

The ALJ entered the Default Order against CI-New York, Yenin, and Rapoport on July 31, 2009. The Default Order imposed sanctions on Rapoport that included an accounting, disgorgement of all "ill-gotten" gains, a lifetime associational bar, and five maximum "second-tier" civil penalties totaling $555,000. JA 477-80.

As the sole basis for imposing $555,000 in maximum "second-tier" civil penalties on Rapoport, the ALJ stated that "the actions of the defaulting Respondents [*i.e.*, Rapoport, Yenin, and CI-New York] demonstrate deliberate or reckless disregard of regulatory requirements." The ALJ reached no independent conclusions about the appropriate penalties for *Rapoport's* conduct. Instead, the ALJ arrived at Rapoport's $555,000 penalty by determining that *CI-New York* should be penalized with a "maximum, second-tier penalty" for "the conduct that occurred" each year from 2003 through 2007, and then applying a "similar methodology" to Rapoport. Even under the ALJ's "methodology," however, the civil penalty against Rapoport should have been $315,000, not $555,000. *See* 15 U.S.C. § 78u(d)(3); 17 C.F.R. § 201.1001.[6]

JA 71-78. The Division made no showing whatsoever that service of process via service on a Russian resident's foreign attorney is consistent with Russian law. JA 71-78; JA 116-20.

[6] The maximum second-tier penalty "for each such act or omission" was $60,000 from 2003-2004, and $65,000 from 2005-2007. It is unclear how the ALJ initially calculated a $555,000 civil penalty. JA 726.

Rapoport's Efforts To Set Aside The Default Order

On December 23, 2009 – shortly after Rapoport was personally served with the OIP and Default Order for the first time upon entering the United States – Rapoport moved the ALJ to set aside the Default Order, and submitted his proposed answer and affirmative defenses to the OIP. JA 484; JA 485-570. The Division submitted an opposition to Rapoport's motion on January 8, 2010 (JA 571-694), and Rapoport submitted his reply on January 22, 2010. JA 695-708. On March 22, 2010, the ALJ denied Rapoport's motion to set aside the Default Order, but "corrected" the ALJ's supposed $240,000 "clerical" error and reduced the civil penalty from $555,000 to $315,000. JA 713-26.

On April 12, 2010, Rapoport moved the Commission to set aside the Default Order. Rapoport argued, among other things, that: (i) he had meritorious defenses to the allegations in the OIP because his conduct did not require him to register with the Commission, and because multiple Rule 15a-6 exemptions applied to his conduct; (ii) there was no basis for imposing on him – even by default – penalties attributable to the years 2003, 2004 and 2005, or "second tier" penalties. JA 727-899. The Division opposed Rapoport's petition on May 27, 2010 (JA 900-1065), and Rapoport submitted his reply on June 10, 2010. JA 1066-89.

The Decision

On July 1, 2010, the Commission denied – without explanation – Rapoport's request for oral argument on his motion to set aside the Default Order. The Commission denied oral argument despite the SEC rule stating that oral argument "shall be granted" absent "exceptional circumstances."[7] JA 1160-61.

On January 20, 2011, the Commission denied Rapoport's motion to set aside the Default Order. JA 1162-73. The Commission held that Rapoport's "reason for failing to defend the proceeding does not support setting aside the Default Order," and *denied Rapoport's motion on that basis alone*, without considering (i) the merit of Rapoport's proposed defenses or (ii) whether the Division would be prejudiced by setting aside the default. JA 1170. The Commission stated – explicitly and unambiguously – that it was not considering Rapoport's proposed defenses in connection with the Decision, because "Rapoport denied himself the opportunity to present [his] defenses when he failed to file a timely answer to the OIP." JA 1173 (n. 33).

The Commission also explained its rationale for refusing to consider Rapoport's defenses:

> The prospect that a default order could be entered based on the allegations in an OIP should motivate respondents

[7] *See* SEC Rule 451. "**Oral Argument Before the Commission** . . . Motions for oral argument . . . shall be granted unless exceptional circumstances make oral argument impractical or inadvisable."

> who have meritorious defenses to engage in the proceeding. Considering whether proposed defenses are meritorious after a default order has been entered would remove or weaken the incentive to so engage. *We therefore do not consider whether Rapoport's defenses might have had merit if asserted at the proper time and if supported by evidence.*

JA 1172 (emphasis added). The Decision did not indicate the commissioner(s) who authored it, the commissioner(s) who participated in the Decision, or whether the Decision was split or unanimous.

Although the lack of any basis for certain sanctions against Rapoport was a central issue in Rapoport's motion to the Commission (JA 727-40), the Commission considered the basis for the sanctions imposed on Rapoport – including the lifetime associational bar and $315,000 in maximum civil penalties – in two perfunctory paragraphs at the conclusion of the Decision. JA 1172-73. With respect to the $315,000 in maximum "second-tier" penalties, the Decision stated only that "[the OIP] alleged facts sufficient to support the imposition of second-tier penalties," and referenced excerpts from the OIP that insufficient to support such penalties. JA 1172. With respect to imposing sanctions on Rapoport attributable to 2003-2005 – years that the OIP does not even *allege* that Rapoport specifically (as opposed to Respondents generally) violated Section 15(a) – the Decision relied only on the same inadequate excerpts in the OIP.

SUMMARY OF ARGUMENT

I. The Commission abused its discretion by ignoring Rapoport's defenses to the OIP when deciding whether or not there was "good cause" to set aside the Default Order. In determining whether there was "good cause" to set aside the Default Order as to Rapoport, the Commission was required to consider not only whether Rapoport's default was "willful," but also whether Rapoport proffered "meritorious defenses" to the OIP, and whether setting aside the default would prejudice the Division. Instead, the Commission expressly rejected the mandatory three-factor balancing test and announced that it would consider only the "willfulness" of Rapoport's default. Had the Commission properly considered all three factors, it would have – or at least should have – determined that there was more than ample "good cause" to set aside the Default Order and permit Rapoport to defend the OIP on its merits.

II. The Commission abused its discretion by failing to meaningfully consider or explain the basis for the sanctions imposed on Rapoport by default, and by imposing sanctions on Rapoport that cannot be justified by the Commission's factual findings and the Commission's own legal standards. At least two categories of sanctions imposed by the Commission were legally and factually unjustified: (i) sanctions against Rapoport attributable to the years 2003, 2004 and

2005 (for which there is no basis whatsoever); and (ii) "second-tier" civil penalties, which require a non-existent – and unsupportable – finding that Rapoport acted with "scienter," *i.e.*, a "mental state embracing intent to deceive, manipulate, or defraud." Therefore, even if the Court does not set aside the Default Order in its entirety (and it should), these baseless sanctions must be vacated.

STANDING

Rapoport seeks review of a Decision that refused to set aside a default order imposing monetary penalties and other sanctions against Rapoport. An order of this Court reversing the Commission's Decision will redress Rapoport's injury.

ARGUMENT

I. The Commission Applied The Wrong Legal Test To Rapoport's Motion To Set Aside The Default Order

The Court ordinarily reviews an agency's legal conclusions for an abuse of discretion[8]; however, because default orders are so disfavored in this Circuit, an abuse of discretion in failing to set aside a default judgment "need not be glaring to justify reversal." *See Keegel v. Key West & Caribbean Trad. Co.*, 627 F.2d 372, 374 (D.C. Cir. 1980) ("*Keegel*"); *Jackson v. Beech*, 636 F.2d 831, 835 (D.C. Cir. 1980) (same). It is an abuse of discretion to "apply the wrong standard" or to "consider an improper factor." *See, e.g.*, *Hill v. Republic of Iraq*, 328 F.3d 680, 683 (D.C. Cir. 2003). Courts in this Circuit apply a more lenient standard for setting aside a default order than for setting aside a default judgment, which is considered more final. *See, e.g.*, *Azamar v. Stern*, 2011 U.S. Dist. LEXIS 61803, at *7 (D.D.C. June 9, 2011).

A default order – including the Default Order entered against Rapoport – may be set aside for "good cause." *See* SEC Rule 155(b); Fed. R. Civ. P. 55(c). Although courts have discretion to determine whether there is "good cause" to set aside a default order, exercising that discretion requires the *mandatory*

[8] *See* 5 U.S.C. § 706(2)(A) (stating that Commission's conclusions may be set aside only if "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.")

consideration of *each of three factors*: (i) the "willfulness" of the default; (2) whether a set-aside would prejudice plaintiff; and (iii) whether the defaulting party has proffered a meritorious defense. *See Keegel*, 627 F. 2d at 373 ("though the decision lies within the discretion of the trial court . . . exercise of that discretion entails consideration of whether (1) the default was willful, (2) a set-aside would prejudice plaintiff, and (3) *the alleged defense was meritorious*") (emphasis added); *see also Mohamad v. Rajoub*, 634 F.3d 604, 606 (D.C. Cir. 2011) ("district court is supposed to consider" each of the three factors); *Delta Sigma Theta Sorority, Inc. v. Lamith Designs, Inc.*, 2011 U.S. Dist. LEXIS 65243, at *13, (D.D.C. June 21, 2011) ("the decision to vacate entry of default lies within the discretion of the trial court, but exercising this discretion requires consideration of [each of the three factors]") (internal quotations omitted); *Azamar*, 2011 U.S. Dist. LEXIS 61803, at *8 ("[b]efore granting a motion to set aside an entry of default, however, a court *must* consider *and weigh* three factors . . .") (emphasis added); *Flynn v. Pulaski Constr. Co., Inc.*, 2006 U.S. Dist LEXIS 1680, at *22-33 (D.D.C. Jan. 6, 2006) (setting aside a "willful" default in light of the other factors, and noting that courts "must" balance the equities and consider each of the factors "under the three-prong good cause standard"); *Capital Yacht Club v. Vessel Aviva*, 228 F.R.D. 389, 392-93 (D.D.C. 2005) (court "should" consider all three factors

"resolving all doubts in favor of the party seeking relief from the default").[9] The mandatory three-factor test for "good cause" is so well-established that *Keegel* – the seminal opinion in this Circuit – stated that reversal can be appropriate if a court merely neglects *to indicate in the opinion* that it has addressed each of the three "good cause" factors. *Keegel*, 627 F. 2d at 374.

Here, the Commission not only failed to address or even consider two of the three factors, but it declared that it was *deliberately disregarding* one factor – the merit of Rapoport's proposed defenses – so as not to "remove or weaken the incentive" to defend against proceedings. JA 1173. The policy announced by the Commission in the Decision (JA 1172) – to "not consider whether Rapoport's defenses might have had merit if asserted at the proper time and if supported by evidence" – is contrary to settled law. By broadcasting that it was ignoring Rapoport's defenses, the Commission declared its contempt for the balancing test that is mandatory in this and other Circuits, which exists in consideration of the "strong policy favoring resolution of disputes on their merits." *Keegel*, 627 F. 2d

[9] *See also SEC v. McNulty*, 137 F.3d 732, 738 (2d Cir. 1998) ("the district court thus has discretion to deny the motion to vacate if it is persuaded that the default was willful *and* is unpersuaded that the defaulting party has a meritorious defense.") (emphasis added); *Medunic v. Lederer*, 533 F.2d 891, 893-94 (3d Cir. 1976) (abuse of discretion for district court to fail to consider the "prejudice" and "meritorious defense" prongs); *Weisner v. 321 West 16th St. Assoc.*, 2000 U.S. Dist. LEXIS 15592, at *12 (S.D.N.Y. Oct. 25, 2000) ("good cause" standard "requires consideration" of each of the three factors); *131 Main St. Assoc. Inc. v. Manko*, 1998 U.S. Dist. LEXIS 18289, at *16 (S.D.N.Y. Nov. 19, 1998) (collecting cases where "willful" default was set aside in light of other two factors).

at 375 ("the interests of justice . . . would be ill-served by resort to a procedural device that would unfairly or unnecessarily foreclose resolution of the dispute on its merits"); *Jackson*, 636 F.2d at 835 ("Default judgments are not favored by modern courts . . . [which are] also reluctant to enter and enforce judgments unwarranted by the facts."); *Webb v. District of Columbia*, 146 F.3d 964, 971 (D.C. Cir. 1998) (default judgment is a "sanction of last resort"). The Commission's deliberate disregard for Rapoport's defenses was a glaring abuse of the Commission's discretion that compels reversal.

Had the Commission actually considered Rapoport's defenses, it would have necessarily concluded that Rapoport had demonstrated a "meritorious defense." "Allegations are meritorious if they contain even a hint of a suggestion which, proven at trial, would constitute a complete defense." *Keegel*, 627 F. 2d at 374. To the extent that Rapoport's conduct as a foreign broker-dealer residing in Moscow and trading in foreign securities required him to register with the Commission (and virtually all of it did not), Rapoport's conduct fit within Rule 15a-6's exemptions to the Commission's registration requirements, including exemptions for: (i) "effect[ing] transactions in securities with or for persons that have not been solicited by the foreign broker or dealer"; (ii) "furnish[ing] research reports to major U.S. institutional investors, and effect[ing] transactions in the securities discussed in the research reports with or for those major U.S.

institutional investors"; (iii) foreign broker-dealers trading in foreign securities solicit transactions, "negotiat[ing] the terms" of those transactions, and "execut[ing] the transactions" abroad[10]; and (iv) the exemption for solicitations of specific types of investors. *See* Rules 15a-6(a)(1),(2),(3), and (4), respectively. JA 727-899; JA 821-59. Rapoport therefore presented far more than the requisite "hint of a suggestion" of a defense that could succeed at trial, especially given the fact-specific nature of the Division's allegations against Rapoport.[11] Whether Rapoport's defenses have "merit" or not – and they plainly do – the Commission abused its discretion by deliberately failing to consider them.

Had the Commission actually considered the other prong of the three-part test that it disregarded – "prejudice" to the Commission – that prong would likewise weigh in favor of setting aside the Default Order. Prejudice in the context of setting aside a default order "is not mere delay, but rather its accompanying dangers: loss of evidence, increased difficulties of discovery, or an enhanced opportunity for fraud or collusion." *Capital Yacht Club,* 228 F.R.D. at 394; *see also Azamar*, 2011 U.S. Dist. LEXIS 61803, at *17-18 ("it is well-established that

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[10] JA 769-70; JA 850 n.185. To the extent that CI-New York allegedly failed to maintain certain records that would allow for this exemption to apply, Rule 15a-6(a)(3)(iii)(A) places the burden on "the registered broker-dealer" – not Rapoport – for those failures.

[11] "Solicitation" in the context of Rule 15a-6 has not been defined by the Commission, but has been said to be a "fact-specific" and "variable" concept that should be "addressed by the staff on a case-by-case basis." JA 821-59.

delay, by itself, does not constitute prejudice") (citations omitted); *Flynn*, 2006 U.S. Dist LEXIS 1680, at *26 ("delay and legal costs are part and parcel of litigation and typically do not constitute prejudice for the purposes of Rule 55(c)".) No such "prejudice" exists here, and the Division was unable to identify any such prejudice when it briefed the issue below.[12] JA 925; JA 1087-88. In any event, whether or not the Division would be prejudiced by setting aside the Default Order – and it would not be – the Commission abused its discretion by failing to consider this mandatory factor.

Lastly, the Commission erred in applying the only prong of the three-part test that it *did* analyze – the "willfulness" of Rapoport's default – because it did not resolve doubts in Rapoport's favor. *See, e.g., Jackson***,** 636 F.2d at 836 ("[o]n a motion for relief from the entry of a default or a default judgment, all doubts are resolved in favor of the party seeking relief."); *Capital Yacht Club*, 228 F.R.D. at 393 (court deciding motion to set aside default "should consider three criteria, resolving all doubts in favor of the party seeking relief from the default"). For example, the Commission did not consider – or address in any way – the indisputable fact that almost immediately after Rapoport was personally served *for*

[12] Indeed, in opposing Rapoport's efforts to defend the OIP on its merits, the Division submitted over 40 pages of detailed briefing to the ALJ and Commission (JA 571-82; JA 900-31) – and marshaled much (if not all) of its "evidence" against Rapoport, including two affidavits by Rapoport's settling co-respondents JA 937-1046. The Division therefore possesses the evidence that is supposedly relevant to its flawed claims against Rapoport.

the first time, he appeared to defend the claims against him. The Commission's conclusion that "Rapoport could not have reasonably believed that he could disregard the ruling and ignore the service effected on him through service on Kraut" (JA 1169) cannot be reconciled with the fact that after Rapoport *was* personally served, he felt compelled to defend, and did defend, the action.

Rapoport's conduct therefore stands in sharp contrast to the conduct of his defaulting co-respondents, including Yenin (who has never appeared to defend against the OIP on its merits), and CI-Moscow (who initially appeared and defended the action for several months, and then, as its former counsel told the ALJ, "made a business decision that they are simply not going to contest the case, that it is not worth their trouble.") JA 144; JA 709-12. Resolving all doubts in Rapoport's favor, these and other mitigating factors[13] with regard to "willfulness" prong should have been credited by the Commission, but they were not. Regardless, whether or not the Commission erred in evaluating the "willfulness" of

[13] The Division's method for obtaining personal jurisdiction over Rapoport – directed service on his former limited-purpose U.S. counsel – is another mitigating factor that the Commission should have considered in evaluating the "willfulness" of Rapoport's "default." Commission Rule of Practice 141(a)(2)(iv) does not allow for service upon persons residing in foreign countries where the method of service is "prohibited by the law of the foreign country." Among other flaws in the order directing service on Rapoport, however, the ALJ concluded that service on Rapoport's U.S. counsel "was not prohibited by Russian law," but premised the decision on the fact that Russian law precluded service on Rapoport through the Hague Convention or ordinary service of process. JA 71-78; JA 116-20.

Rapoport's default, it was an abuse of the Commission's discretion not to balance the degree of "willfulness" against other mandatory considerations.

II. The Commission Abused Its Discretion By Imposing Capricious Sanctions On Rapoport That Are Not Supported By The Well-Pleaded Allegations In The OIP

This Court will reverse sanctions that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law." *See* 5 U.S.C. § 706(2)(A). The Commission abuses its discretion by imposing sanctions that are "unwarranted in law" or "without justification in fact." *KPMG, LLP v. SEC*, 289 F.3d 109, 121 (D.C. Cir. 2002). Sanctions that fail to comply with the Commission's "own standard" for imposing the sanction are unwarranted in law. *Id*. Sanctions that are imposed without providing "meaningful consideration" of the circumstances of the case and without an explanation of the Commission's reasoning are without justification in fact. *The Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1099 (D.C. Cir. 2005) (vacating "third-tier" civil penalties "because the SEC did not explain its reasoning" for the sanctions or "even cursorily explain" why the necessary elements for such sanctions were satisfied); *see also Jost v. Surface Transp. Bd.*, 194 F.3d 79, 85 (D.C. Cir. 1999) ("The requirement that agency action not be arbitrary and capricious includes a requirement that the

agency adequately explain its result").[14] Therefore, assuming *arguendo* that the Court does not set aside the default order in its entirety, several of the penalties imposed on Rapoport by default must be vacated, because they are without legal or factual justification.[15]

The Commission addressed the sanctions imposed on Rapoport by default – which included a *lifetime* associational bar, disgorgement of all income "connected" to Rapoport's Section 15(a) violation, and $315,000 in "maximum, second-tier" civil penalties – in only *five* perfunctory sentences at the conclusion of the Decision. JA 1172-73. It is therefore clear from the face of the Decision that

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[14] *See also McCarthy v. SEC*, 406 F.3d 179, 190 (2d Cir. 2005) (abuse of discretion for the Commission to fail to "meaningfully consider and explain its bases for imposing sanctions," or to impose sanctions that are "palpably disproportionate to the violation"); *Monetta Fin. Servs., Inc. v. SEC*, 390 F.3d 952, 957-58 (7th Cir. 2004) (vacating the SEC's order imposing sanctions where the SEC "referenc[ed], but did not 'meaningfully consider,' whether the circumstances of the case merited the sanctions awarded").

[15] Even where an order is entered by default, the Commission has an obligation to "make an independent determination" of damages, *Int'l Painters & Allied Trades Indus. Pension Fund v. R.W. Amrine Drywall Co.*, 239 F. Supp.2d 26, 30 (D.D.C. 2002) (citing Fed. R. Civ. P. 55(b)), because "[e]ven when a default judgment is warranted based on a party's failure to defend, the allegations in the complaint with respect to the amount of the damages are not deemed true" and "it is necessary to take account or to determine the amount of damages or to establish the truth of any averment by evidence," *Credit Lyonnais Sec. (USA), Inc. v. Alcantara*, 183 F.3d 151,154-55 (2d Cir. 1999)). A defaulting defendant is deemed to have admitted only the "*well-pleaded allegations* of the complaint," and "unless the amount of damages is certain, the court is required to make an independent determination of the sum to be awarded." *See Adkins v. Teseo,*180 F. Supp.2d 15, 17 (D.D.C. 2001) (emphasis added).

the Commission failed to "meaningfully consider" whether there were grounds for the sanctions imposed on Rapoport, and failed to explain its reasons for imposing those sanctions. *See Rockies Fund*, 428 F.3d at 1095 (vacating penalty "because the SEC did not explain its reasoning"); *see also SEC v. Chenery Corp.*, 318 U.S. 80, 94-97(1943) ("The orderly functioning of the process of review requires that the grounds upon which the administrative agency acted be clearly disclosed and adequately sustained …. it will not do for a court to be compelled to guess at the theory underlying the agency's action"); *see also Steadman v. SEC*, 603 F.2d 1126, 1139 (5th Cir. 1979) ("We subscribe to the common-sense notion that the greater the sanction the Commission decides to impose, the greater is its burden of justification.")

The Commission's virtually non-existent sanctions analysis failed to correct the Default Order's deeply flawed methodology for imposing sanctions on Rapoport. Specifically, the Default Order wrongly assumed that Rapoport: (i) had engaged in the *same conduct* as his co-respondents; (ii) had engaged in that conduct during the *same years* as his co-respondents; and (iii) faced the same claims as his co-respondents.[16] When the Default Order ostensibly attempted to

[16] As opposed to the single violation of Section 15(a) alleged against Rapoport, the OIP also alleged four additional violations against CI-New York, and three additional violations against Yenin. Specifically, the OIP alleged that CI-New York, unlike Rapoport, violated Sections 15(a) and 17(a), and Rules 15(b)3-1, 17a-4(b)(4), and 17a-4(j) of the Exchange Act, and that Yenin, unlike Rapoport,

"parse up the violations" by the three defaulting respondents in the Default Order (JA 467), the Default Order drew no distinctions whatsoever between the conduct of *Rapoport* (a foreign broker-dealer, residing in Russia, alleged to have "controlled" CI-New York in 2006 and 2007 *only*), and the obviously different conduct of *Yenin* (a registered representative with seven SEC licenses, including the Series 27 for regulatory compliance, who served as CI-New York's managing director, CFO, and FINOP from 2003-2005)[17] and *CI-New York* (the registered New York broker-dealer responsible for regulatory compliance.) Instead, the Default Order made the unsubstantiated assertion that the "actions of the defaulting Respondents demonstrate deliberate or reckless disregard of regulatory requirements." The Default Order then imposed the "maximum, second-tier penalty" against *CI-New York* for *its* conduct each year from 2003 through 2007, and applied that "methodology" *to Rapoport* without explanation, justification, or analysis.[18] JA 467. The Default Order's methodology failed to distinguish between the conduct of Rapoport and his co-respondents, and was therefore profoundly flawed. Yet the Commission rotely imposed the Default Order's

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violated Sections 15(a) and 17(a), and Rules 15(b)3-1, 17a-4(b)(4) of the Exchange Act. JA 468.

[17] JA 27-28 (¶7); JA 1078

[18] Compounding the error (and demonstrating the Default Order's carelessness imposing sanctions on an absent respondent), the Default Order applied this methodology to Rapoport using flawed math (JA 726), and initially imposed $240,000 *more* in civil penalties than what the ALJ had intended.

baseless sanctions on Rapoport without any scrutiny, analysis or consideration whatsoever.

Accordingly, at least two categories of sanctions imposed by the Commission were legally and factually unjustified. *First*, because the OIP *did not even allege* that Rapoport (as opposed to his co-respondents) violated Section 15(a) from 2003-2005, the Commission abused its discretion when it imposed penalties on Rapoport attributable to those years. (*See* II(A), *infra*.) *Second*, the Commission abused its discretion when it imposed "second-tier" civil penalties on Rapoport, which require a finding – for which there is no basis – that Rapoport acted with "scienter," *i.e.*, a "mental state embracing intent to deceive, manipulate, or defraud." (*See* II(B), *infra*.)

A. Sanctions Attributable To 2003-2005 Are Neither Justified By The Facts Nor Legally Warranted

The Commission gave no consideration whatsoever – meaningful or otherwise – to whether the well-pleaded allegations in the OIP concerning *2003-2005* supported sanctions against Rapoport, as opposed to his co-respondents. The Commission came closest to attempting to justify sanctions against Rapoport in a footnote (JA 1172, n.32) that cites selectively – and misleadingly – from the OIP. But nowhere in the OIP is there any allegation that Rapoport – as opposed to his

employer (CI-Moscow) or other CI-Moscow employees – directly or indirectly[19] solicited investors in the U.S. from 2003-2005. What the OIP actually alleges with respect to Rapoport specifically is that Rapoport "controlled" CI-New York *only in 2006 and 2007*. JA 29 (¶ 17.) In other words, the well-pleaded allegations in the OIP provide no basis for sanctioning Rapoport for his 2003-2005 conduct. *See Adkins*, 180 F. Supp.2d at 17 (A defaulting defendant is "deemed to have admitted only the well-pleaded allegations of the complaint"). Consequently, all of the sanctions attributable to those years – including an accounting, disgorgement, as well as three "maximum, second-tier" civil penalties totaling $185,000 – must be set aside.[20]

There are also several additional reasons that the sanctions attributable to the year 2003 – including the $60,000 maximum civil penalty attributable to that year alone – must be vacated. *First*, the Division's claims are subject to a five-year

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[19] Neither the Division, the ALJ, nor the Commission have ever elucidated their theory of how Rapoport's "direction" of CI-New York employees constitutes "control" under the securities laws such that Rapoport can be charged with "indirect solicitation" in violation of Section 15(a). That is in any event immaterial to this appeal, however, because the OIP does not allege that Rapoport "controlled" CI-New York from 2003-2005. JA 29 (¶ 17).

[20] Critically, the lack of well-pleaded allegations in the OIP reflect the Division's complete lack of evidence to support any "direct or indirect" solicitations of U.S. investors by Rapoport (as opposed to his co-respondents) from 2003-2005. *Jackson*, 636 F.2d at 835 ("Default judgments are not favored by modern courts . . . [which are] also reluctant to enter and enforce judgments unwarranted by the facts."); JA 1079-80.

statute of limitations, and conduct occurring before December 8, 2003 may not be considered in determining whether to impose a civil penalty. (JA 719, fn. 6); *see also* 28 U.S.C. § 2462. Yet the Commission imposed the same "maximum" second-tier penalty for less than 10% of 2003 that it did for subsequent "full" years. *Second*, the allegations in the OIP of misconduct beginning in "about 2003" is an insufficient basis for imposing a full "maximum" second-tier penalty on Rapoport for that year. Indeed, the Division subsequently acknowledged its complete lack of evidence to support any violations in 2003 when it filed a civil complaint in August 2009 seeking final judgment against Chekholko, and alleged that the conduct in the OIP occurred "from *at least 2004* through November 2007." *See SEC v. Chekholko*, 09 cv 6937, filed August 6, 2009 (emphasis added). The Commission's failure to address the obvious lack of any basis for sanctions against Rapoport for 2003 demonstrates the extent to which the Commission failed to "meaningfully consider" or explain in any way the sanctions imposed on Rapoport by default.

B. "Second-Tier" Penalties Against Rapoport Are Neither Justified By The Facts Nor Legally Warranted

"Second-tier" civil penalties require a finding that Rapoport's conduct involved "fraud, deceit, manipulation or deliberate or reckless disregard of a regulatory requirement," *see* 15 U.S.C. § 78u-2(b)(2), *i.e.*, a finding that Rapoport acted with scienter. *See SEC v. M&A West, Inc.*, 538 F.3d 1043 (9th Cir. 2008)

("the imposition of second-tier penalties requires an assessment of scienter".) The Commission abused its discretion when it imposed five "maximum, second-tier penalties" against Rapoport, because neither the well-pleaded allegations in the OIP – nor the Division's evidence – justify a finding that Rapoport acted with scienter.

Of the five sentences in the Decision discussing the sanctions against Rapoport, ten words are devoted to the $315,000 in civil penalties levied against Rapoport: the OIP "alleged facts sufficient to support the imposition of second-tier penalties." JA 1172. The Commission provided no further analysis on the issue.[21] Because the Commission failed to meaningfully analyze the basis for imposing "second-tier" penalties on Rapoport, those penalties must be vacated. *See Rockies Fund*, 428 F.3d at 1099 (vacating "third-tier" sanctions where the SEC imposed third-tier sanctions without "even cursorily explain[ing]" why the necessary elements for such sanctions were satisfied); *see also Monetta Fin. Serv's, Inc. v. SEC* 390 F. 3d 952, 957-58 (7th Cir. 2004) (reversing SEC sanctions as excessive where SEC's opinion did "not reflect that the SEC meaningfully considered [the

[21] As discussed above, the ALJ similarly failed to consider whether there was a basis for imposing second-tier penalties on Rapoport, and made only the conclusory determination – as to Rapoport, Yenin, and CI-New York *collectively* – that "the actions of the defaulting Respondents demonstrate deliberate or reckless disregard of regulatory requirements." JA 467. The Default Order therefore provided no basis for "second-tier" penalties against Rapoport, as opposed to his differently-situated co-respondents. JA 725-26.

relevant] factors when it imposed the sanctions."); *WHX Corp. v. SEC*, 362 F. 3d 854, 859 (reversing SEC cease-and-desist order where the SEC failed "seriously consider" the factors relevant to imposing such an order). Indeed, the OIP does not allege that Rapoport acted with scienter, the Commission ignored the issue entirely, and the ALJ never explained why Rapoport – as opposed to his defaulting co-respondents – acted with scienter.

Moreover, the subjective nature and complexity of Rule 15a-6 belies a conclusion that under the circumstances, Rapoport acted with scienter a "mental state embracing intent to deceive, manipulate, or defraud." *See Ernst and Ernst v. Hochfelder*, 425 U.S. 185, 96 (1976). Rule 15a-6 – the Registration Requirements for Foreign Broker-Dealers – sets forth a cornucopia of conduct that foreign broker-dealers may engage in without registering with the Commission. [22] Compliance with Rule 15a-6 is decidedly beyond the ken of the non-specialist, and the requirements of Rule 15a-6 are described in an Adopting Release spanning 39

[22] Indeed, every year from 1999 through 2007, CI-New York *advised the Commission*, in its annual Form X-17A-5 reports, that CI-New York was "an introducing broker with respect to domestic and certain foreign securities transactions" that "clears Russian securities transactions through facilities provided by the Parent [CI-Moscow]." JA 472 (n.4). In other words, CI-New York told the Commission on an annual basis for nine years that it was engaging in the conduct that the Division now alleges violated Section 15(a) in the OIP. If CI-New York – where Rapoport worked from 1999 through 2001, and who Rapoport allegedly "controlled" in 2006 and 2007 (JA 27 ¶ 6) – believed its arrangement with CI-Moscow to be improper, why would it have disclosed that arrangement to the Commission each year from 1999 to 2007?

pages, containing 218 substantive footnotes, and incorporating several "interpretative statements" by Commission.[23] The nuances of the Rule confounded the ALJ in the Default Order, and the requirements of Rule 15a-6 were sufficiently complicated that Yenin – CI-New York's managing director with seven SEC licenses, including the Series 27 for record-keeping and regulatory compliance (JA 1078) – sought guidance from external consultants to ensure compliance with the Rule. JA 28 (¶ 13).[24] Indeed, it should be dispositive of all "second-tier" penalties that the Division conceded that Rapoport would not have been required to register with the Commission *at any time* from 2003-2007 if CI-New York would have fulfilled *its* responsibility to maintain records and accept service on Rapoport's behalf. *See* Rule 15a-6(3)(iii)(D); JA 1084-85. And, the Proposed Amendment to the Rule, if passed, would eliminate these record-keeping requirements. JA 817-20.

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[23] In or about 1998, CI-New York and CI-Moscow obtained legal opinions stating that CI-New York's relationship with CI-Moscow with respect to soliciting investors and executing trades was in accordance with U.S. law. JA 515-16 (¶¶ 3, 5).

[24] The ALJ misconstrued the Rule in the Default Order by failing to consider, among other things, footnote 185 of the Adopting Release, which provides – contrary to the ALJ's conclusion that "Rapoport's conduct violated Section 15(a)" *because* "U.S. investors were solicited" and "their transactions were executed through CI-Moscow" – that foreign broker-dealers *may*, under a variety of circumstances, execute transactions in foreign securities. *See* Rule 15a-6(a)(3); JA 850.

In addition, where a sanction imposed by the Commission is "excessive" or does not "serve [its] intended purpose," an appellate court has the discretion to "reduce" it, or to "eliminate" it entirely. *McCarthy*, 406 F.3d at 188; *Hateley v. SEC*, 8 F.3d 653, 655 (9th Cir. 1993) (a "court may reduce an SEC sanction where its severity is not justified under the circumstances"). Here, even assuming there was a basis for finding that Rapoport acted with scienter (and there is not), the five maximum second-tier penalties imposed on Rapoport totaling $315,000 are excessive by any objective measure as (i) Rapoport has no prior violations of the securities laws; (ii) his alleged violation caused no harm to investors; (iii) the Division implicitly concedes (JA 924-25) that all of his conduct would have been exempt from registration under Rule 15a-6 had CI-New York maintained certain records and registered him for service; and (iv) the Commission has effectively proposed eliminating these record-keeping requirements. JA 817-20. By imposing such excessive penalties, the Commission failed to give "meaningful consideration" to the specific circumstances of this case. *See, e.g., McCarthy*, 406 F.3d at 190 ("Some explanation addressing the nature of the violation and the mitigating factors presented in the record of each case is required . . . we reiterate that each case must be considered on its own facts"); *SEC v. Moran*, 944 F. Supp. 286, 297 (S.D.N.Y. 1996) ("Each case, of course, has its own particular facts and circumstances which determine the appropriate penalty to be imposed").

The Commission therefore abused its discretion by imposing *all* penalties against Rapoport attributable to 2003-2005, and by imposing "second-tier" penalties for 2006-2007. Therefore, in the event that the Default Order is not set aside, all of these sanctions should be vacated in their entirety.

CONCLUSION

For the reasons set forth herein, Rapoport respectfully requests that the Court set aside the Default Order as to him so that he may defend the OIP on its merits. In the alternative, Rapoport respectfully requests that at a minimum, the Court vacate the sanctions imposed on him by the Commission that are without legal and factual justification, which include: (i) all sanctions and penalties attributable to the years 2003, 2004 and 2005 (including an accounting, disgorgement, and civil penalties); and (ii) all "second-tier" civil penalties against Rapoport for all years.

Respectfully submitted,

Dated: December 19, 2011

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CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32, I hereby certify that Final Brief of Petitioner Dan Rapoport complies with the type-volume limitation because it is 7,871 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii) and Circuit Rule 32(a)(2), and is written in Times New Roman 14-point font.

Dated: December 19, 2011

/s/ Michael A. Hanin
Michael A. Hanin

CERTIFICATE OF SERVICE

Pursuant to Federal Rule of Appellate Procedure 25(d)(2), I hereby certify that Final Brief of Petitioner Dan Rapoport was served on Respondent Securities and Exchange Commission via the Case Management/Electronic Case Filing system of the United States Court of Appeals, District of Columbia Circuit, which will send notice of such filing to the following registered CM/ECF users:

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A courtesy copy will also be emailed to the above email addresses.

Dated: December 19, 2011 /s/ Michael A. Hanin

Michael A. Hanin

ADDENDUM

TABLE OF CONTENTS: STATUTES

STATUTES ADDENDUM

15 U.S.C. § 78y provides in relevant part:

> (a) Final Commission orders; persons aggrieved; petition; record; findings; affirmance, modification, enforcement, or setting aside of orders; remand to adduce additional evidence.
>
> > (1) A person aggrieved by a final order of the Commission entered pursuant to this title [15 USCS §§ 78a et seq.] may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.

Section 15(a) of the Exchange Act provides in relevant part:

Registration of all persons utilizing exchange facilities to effect transactions; exemptions

1. It shall be unlawful for any broker or dealer which is either a person other than a natural person or a natural person not associated with a broker or dealer which is a person other than a natural person (other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange) to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such broker or dealer is registered in accordance with subsection (b) of this section.

Rule 15a-6 of the Exchange Act provides:

a. A foreign broker or dealer shall be exempt from the registration requirements of sections 15(a)(1) or 15B(a)(1) of the Act to the extent that the foreign broker or dealer:

1. Effects transactions in securities with or for persons that have not been solicited by the foreign broker or dealer; or

2.Furnishes research reports to major U.S. institutional investors, and effects transactions in the securities discussed in the research reports with or for those major U.S. institutional investors, provided that:

i. The research reports do not recommend the use of the foreign broker or dealer to effect trades in any security;

ii. The foreign broker or dealer does not initiate contact with those major U.S. institutional investors to follow up on the research reports, and does not otherwise induce or attempt to induce the purchase or sale of any security by those major U.S. institutional investors,

iii. If the foreign broker or dealer has a relationship with a registered broker or dealer that satisfies the requirements of paragraph (a)(3) of this section, any transactions with the foreign broker or dealer in securities discussed in the research reports are effected only through that registered broker or dealer, pursuant to the provisions of paragraph (a)(3) of this section; and

iv. The foreign broker or dealer does not provide research to U.S. persons pursuant to any express or implied understanding that those U.S. persons will direct commission income to the foreign broker or dealer; or

3. Induces or attempts to induce the purchase or sale of any security by a U.S. institutional investor or a major U.S. institutional investor, provided that:

i. The foreign broker or dealer:

A. Effects any resulting transactions with or for the U.S. institutional investor or the major U.S. institutional investor through a registered broker or dealer in the manner described by paragraph (a)(3)(iii) of this section; and

B. Provides the Commission (upon request or pursuant to agreements reached between any foreign securities authority,

including any foreign government, as specified in section 3(a)(50) of the Act, and the Commission or the U.S. Government) with any information or documents within the possession, custody, or control of the foreign broker or dealer, any testimony of foreign associated persons, and any assistance in taking the evidence of other persons, wherever located, that the Commission requests and that relates to transactions under paragraph (a)(3) of this section, except that if, after the foreign broker or dealer has exercised its best efforts to provide the information, documents, testimony, or assistance, including requesting the appropriate governmental body and, if legally necessary, its customers (with respect to customer information) to permit the foreign broker or dealer to provide the information, documents, testimony, or assistance to the Commission, the foreign broker or dealer is prohibited from providing this information, documents, testimony, or assistance by applicable foreign law or regulations, then this paragraph (a)(3)(i)(B) shall not apply and the foreign broker or dealer will be subject to paragraph (c) of this section;

ii. The foreign associated person of the foreign broker or dealer effecting transactions with the U.S. institutional investor or the major U.S. institutional investor:

A. Conducts all securities activities from outside the U.S., except that the foreign associated persons may conduct visits to U.S. institutional investors and major U.S. institutional investors within the United States, provided that:

1. The foreign associated person is accompanied on these visits by an associated person of a registered broker or dealer that accepts responsibility for the foreign associated person's communications with the U.S. institutional investor or the major U.S institutional investor; and

2. Transactions in any securities discussed during the visit by the foreign associated person are effected only through the registered broker or dealer, pursuant to paragraph (a)(3) of this section; and

B. Is determined by the registered broker or dealer to:

1. Not be subject to a statutory disqualification specified in Section 3(a)(39) of the Act, or any substantially equivalent foreign

1.expulsion or suspension from membership,

2. bar or suspension from association,

3. denial of trading privileges,

4. order denying, suspending, or revoking registration or barring or suspending association, or

5. finding with respect to causing any such effective foreign suspension, expulsion, or order;

2. Not to have been convicted of any foreign offense, enjoined from any foreign act, conduct, or practice, or found to have committed any foreign act substantially equivalent to any of those listed in sections 15(b)(4) (B), (C), (D), or (E) of the Act; and

3. Not to have been found to have made or caused to be made any false foreign statement or omission substantially equivalent to any of those listed in Section 3(a)(39)(E) of the Act; and

iii. The registered broker or dealer through which the transaction with the U.S. institutional investor or the major U.S. institutional investor is effected:

A. Is responsible for:

1. Effecting the transactions conducted under paragraph (a)(3) of this section, other than negotiating their terms;

2. Issuing all required confirmations and statements to the U.S. institutional investor or the major U.S. institutional investor;

3. As between the foreign broker or dealer and the registered broker or dealer, extending or arranging for the extension of any credit to the U.S. institutional investor or the major U.S. institutional investor in connection with the transactions

4. Maintaining required books and records relating to the transactions, including those required by Rules 17a-3 and 17a-4 under the Act

5. Complying with Rule 15c3-1 under the Act with respect to the transactions; and

6. Receiving, delivering, and safeguarding funds and securities in connection with the transactions on behalf of the U.S. institutional investor or the major U.S. institutional investor in compliance with Rule 15c3-3 under the Act;

B. Participates through an associated person in all oral communications between the foreign associated person and the U.S. institutional investor, other than a major U.S. institutional investor;

C. Has obtained from the foreign broker or dealer, with respect to each foreign associated person, the types of information specified in Rule l7a-3(a)(12) under the Act, provided that the information required by paragraph (a)(12)(d) of that Rule shall include sanctions imposed by foreign securities authorities, exchanges, or associations, including without limitation those described in paragraph (a)(3)(ii)(B) of this section;

D. Has obtained from the foreign broker or dealer and each foreign associated person written consent to service of process for any civil action brought by or proceeding before the Commission or a self-regulatory organization (as defined in Section 3(a)(26) of the Act), providing that process may be served on them by service on the registered broker or dealer in the manner set forth on the registered broker's or dealer's current Form BD; and

E. Maintains a written record of the information and consents required by paragraphs (a)(3)(iii)(C) and(D) of this section, and all records in connection with trading activities of the U.S. institutional investor or the major U.S. institutional investor involving the foreign broker or dealer conducted under paragraph (a)(3) of this section, in an office of the registered broker or dealer located in the United States (with respect to nonresident registered brokers or dealers, pursuant to Rule 17a-7(a) under the Act, and makes these records available to the Commission upon request; or

4. Effects transactions in securities with or for, or induces or attempts to induce the purchase or sale of any security by:

i. A registered broker or dealer, whether the registered broker or dealer is acting as principal for its own account or as agent for others, or a bank acting pursuant to an exception or exemption from the definition of "broker" or "dealer" in sections 3(a)(4)(B), 3(a)(4)(E), or 3(a)(5)(C) of the Act, or the rules thereunder;

ii. The African Development Bank, the Asian Development Bank, the Inter-American Development Bank, the International Bank for Reconstruction and Development, the International Monetary Fund, the United Nations, and their agencies, affiliates, and pension funds;

iii. A foreign person temporarily present in the United States, with whom the foreign broker or dealer had a bona fide, pre-existing relationship before the foreign person entered the United States;

iv. Any agency or branch of a U.S. person permanently located outside the United States, provided that the transactions occur outside the United States; or

v. U.S. citizens resident outside the United States, provided that the transactions occur outside the United States, and that the foreign broker or dealer does not direct its selling efforts toward identifiable groups of U.S. citizens resident abroad.

b. When used in this rule,

1. The term family of investment companies shall mean:

i. Except for insurance company separate accounts, any two or more separately registered investment companies under the Investment Company Act of 1940 that share the same investment adviser or principal underwriter and hold themselves out to investors as related companies for purposes of investment and investor services; and

ii. With respect to insurance company separate accounts, any two or more separately registered separate accounts under the Investment Company Act of 1940 that share the same investment adviser or principal underwriter and function under operational or accounting or control systems that are substantially similar.

2. The term foreign associated person shall mean any natural person domiciled outside the United States who is an associated person, as defined in Section 3(a)(18) of the Act, of the foreign broker or dealer, and who participates in the solicitation of a U.S. institutional investor or a major U.S. institutional investor under paragraph (a)(3) of this section.

3. The term foreign broker or dealer shall mean any non-U.S. resident person (including any U.S. person engaged in business as a broker or dealer entirely outside the United States, except as otherwise permitted by this rule) that is not an office or branch of, or a natural person associated with, a registered broker or dealer, whose securities activities, if conducted in the United States, would be described by the definition of "broker" or "dealer" in Sections 3(a)(4) or 3(a)(5) of the Act.

4. The term major U.S. institutional investor shall mean a person that is:

i. A U.S. institutional investor that has, or has under management, total assets in excess of $100 million; provided, however, that for purposes of determining the total assets of an investment company under this rule, the investment company may include the assets of any family of investment companies of which it is a part; or

ii. An investment adviser registered with the Commission under Section 203 of the Investment Advisers Act of 1940 that has total assets under management in excess of $100 million

5. The term registered broker or dealer shall mean a person that is registered with the Commission under Sections 15(b), 15B(a)(2), or 15C(a)(2) of the Act

6. The term United States shall mean the United States of America, including the States and any territories and other areas subject to its jurisdiction.

7. The term U.S. institutional investor shall mean a person that is:

i. An investment company registered with the Commission under Section 8 of the Investment Company Act of 1940; or

ii. A bank, savings and loan association, insurance company, business development company, small business investment company, or employee benefit plan defined in Rule 501(a)(1) of Regulation D under the Securities Act of 1933; a private business development company defined in Rule 501(a)(2); an organization described in Section 501(c)(3) of the Internal Revenue Code, as defined in Rule 501(a)(3) ; or a trust defined in Rule 501(a)(7).

c. The Commission, by order after notice and opportunity for hearing, may withdraw the exemption provided in paragraph (a)(3) of this section with respect to the subsequent activities of a foreign broker or dealer or class of foreign brokers or dealers conducted from a foreign country, if the Commission finds that the laws or regulations of that foreign country have prohibited the foreign broker or dealer, or one of a class of foreign brokers or dealers, from providing, in response to a request from the Commission, information or documents within its possession, custody, or control, testimony of foreign associated persons, or assistance in taking the evidence of other persons, wherever located, related to activities exempted by paragraph (a)(3) of this section.

5 U.S.C. § 706 provides:

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall--

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
>
> (B) contrary to constitutional right, power, privilege, or immunity;
>
> (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;
>
> (D) without observance of procedure required by law;
>
> (E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title [5 USCS §§ 556 and 557] or otherwise reviewed on the record of an agency hearing provided by statute; or
>
> (F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.
>
> In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

15 USCS § 78u-2 provides in relevant part:

> (2) Second tier. Notwithstanding paragraph (1), the maximum amount of penalty for each such act or omission shall be $ 50,000 for a natural person or $ 250,000 for any other person if the act or omission described in subsection (a) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement