JS-6

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	**CV 14-06865-RGK (Ex)**	Date	October 28, 2015
Title	***SECURITIES AND EXCHANGE COMMISSION v. JUSTIN MOONGYU LEE, et al***		

Present: The Honorable	R. GARY KLAUSNER, U.S. DISTRICT JUDGE	
Sharon L. Williams (Not Present)	Not Reported	N/A
Deputy Clerk	Court Reporter / Recorder	Tape No.

Attorneys Present for Plaintiffs:	Attorneys Present for Defendants:
Not Present	Not Present

Proceedings: **(IN CHAMBERS) Order Re: Motion for Default Judgment (DE 39)**

I. INTRODUCTION

On September 3, 2014, the Securities and Exchange Commission ("SEC" or "Plaintiff") filed a Complaint against Justin Moongyu Lee ("J. Lee"), Rebecca Taewon Lee ("R. Lee"), Thomas Edward Kent ("Kent"), and the following entities: American Immigrant Investment Fund I, LLC, ("AIIF"), Biofuel Venture IV, LLC, ("Biofuel IV"), Biofuel Venture V, LLC ("Biofuel V"), Nexland, Inc., dba Nexland Investment Group ("Nexland"), and Nexsun Ethanol, LLC ("Nexsun") (collectively, the "Entity Defendants"). The Complaint alleges violations of section 17(a) of the Securities Act of 1933 ("Securities Act"), sections 10(b) and 20(a) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 10b-5 thereunder, for fraud in connection with the purchase, offer, or sale of securities.

Pursuant to the SEC's request, the clerk entered default against the Entity Defendants and J. Lee on March 17, 2015 and August 7, 2015, respectively. On September 21, 2015, pursuant to stipulations for settlement, the Court entered final judgment as to R. Lee and Kent.

Presently before the Court is the SEC's Motion for Default Judgment Against Defendant J. Lee and the Entity Defendants ("Motion"). For the following reasons, the Court **GRANTS** the SEC's Motion.

II. FACTUAL BACKGROUND

The SEC alleges the following facts in the Complaint:

This case involves a scheme perpetrated by two immigration attorneys, J. Lee and his partner Kent, as well as J. Lee's spouse, R. Lee. The scheme involved defrauding Chinese and Korean investors

by claiming that their monies would be invested in a program that met the requirements of the United States EB-5 visa program.

J. Lee founded, and was the CEO, of each of the Entity Defendants. In addition to his role as CEO, he was the president, secretary, managing member, and/or the chairman of the board of directors of several of the Entity Defendants. He was also the signatory on all bank accounts for each of these entities. Further, J. Lee was the founder, CEO, and sole owner of a related entity, Kansas Biofuel Regional Center, LLC ("Kansas Biofuel").

Under the EB-5 visa program, which is administered by the United States Citizenship and Immigration Service ("USCIS"), an immigrant who invests capital in a "commercial enterprise" in the United States may petition for and receive conditional permanent residency status for a two-year period. If the required program conditions are met, he may receive permanent residency. The immigrant must invest at least $500,000.00 in a Target Employment Area ("TEA") and thereby create at least ten full-time jobs for United States workers. To facilitate investment and job opportunities, the program allows entities to apply to USCIS to become approved "regional centers."

The fraudulent scheme began in 2006, when J. Lee and Kent applied to USCIS on behalf of Kansas Biofuel for designation as a regional center. Among other representations, J. Lee and Kent claimed to the USCIS that, through Nexsun, they were going to construct and operate a new ethanol plant in Kansas that would create thousands of jobs and substantial economic benefit. Once USCIS designated Kansas Biofuel as a regional center in 2007, J. Lee and Kent created various companies, including AIIF, Biofuel IV, and Biofuel V, through which to raise monies from immigrant investors.

From March 2009 to April 2011, defendants raised $11,455,000.00 from twenty-four investors through three offerings of shares in AIIF, Biofuel IV, and Biofuel V, to purportedly construct an ethanol plant in Kansas. Depending on the particular entity that was invested in, each investor paid $505,000.00-$530,000.00. Each investment constituted a security in the form of an investment contract because each investment involved: (1) an investment of money; (2) in a common enterprise; (3) with profits to come from the efforts of others.

Contrary to defendants' representations, no ethanol plant was ever built. Instead, J. Lee and R. Lee misappropriated and misused most of the $11.5 million. In particular, they spent almost $3.9 million to finance an unrelated project in the Philippines, and another $2.38 million to pay off investors in other offerings. These expenditures were neither permissible under the EB-5 program nor disclosed to investors.

Defendants knew that Nexsun would not construct the ethanol plant. However, they continued to make explicit representations to investors and the USCIS that work on the plant was ongoing. As part of their offering materials, defendants provided investors with a Nexsun Business Plan, which stated that "Major construction work is ongoing and the plant will be in operation before November 2011." (Compl. ¶ 35.) Defendants also conveyed this information to investors at seminars that they held from 2008 to 2010.

To conceal their misuse of funds and failure to construct the ethanol plant, J. Lee and R. Lee caused employees to be hired by Nexsun, but paid them for performing tasks unrelated to construction of the ethanol plant. Then, as required by the USCIS, defendants submitted a Form 1-9 to the USCIS identifying each employee that they hired, which purportedly evidenced the required creation of jobs. J. Lee, R. Lee, and Kent each signed the false documents submitted to the USCIS.

III. JUDICIAL STANDARD

Federal Rule of Civil Procedure ("Rule") 55(b) allows for a court-ordered default judgment following entry of default by the clerk when a party has failed to plead or otherwise defend a case. Pursuant to Rule 55(b)(2) and Local Rule of the Central District of California 55-1, the application for default judgment shall set forth the following information: (1) when and against what party the default was entered; (2) the identification of the pleading to which default was entered; (3) whether the defaulting party is an infant or incompetent person, and if so, whether that person is represented by a general guardian, committee, conservator or other representative; (4) that the Servicemembers Civil Relief Act (50 U.S.C. App. § 521) does not apply; and (5) that notice has been served on the defaulting party, if required by Federal Rule of Civil Procedure 55(b)(2).

Entry of default does not automatically entitle a plaintiff to a court-ordered judgment. *Aldabe v. Aldabe*, 616 F.2d 1089, 1092 (9th Cir. 1980). Instead, the decision whether to enter a default judgment is within the court's sound discretion. *Id*. The Ninth Circuit has enumerated the following factors for courts to consider when exercising discretion as to the entry of default judgment: (1) the possibility of prejudice to the plaintiff; (2) the merits of plaintiff's substantive claim; (3) the sufficiency of the complaint; (4) the sum of money at stake in the action; (5) the possibility of a dispute concerning material facts; (6) whether the default was due to excusable neglect; and (7) the strong policy underlying the Rules' favoring decisions on the merits (collectively, the "*Eitel* Factors"). *Eitel v. McCool*, 782 F.2d 1470, 1471-72 (9th Cir. 1986).

In general, once the clerk has entered default, all factual allegations in the complaint will be taken as true. *TeleVideo Sys., Inc. v. Heidenthal*, 826 F.2d 915, 917-18 (9th Cir. 1987). However, if the plaintiff is seeking money damages, the plaintiff is required to provide evidence of its damages, and the damages sought must not be different in kind or amount from those set forth in the complaint. *Amini Innovation Corp. v. KTY Int'l Mktg.*, 768 F. Supp. 2d 1049, 1054 (C.D. Cal. 2011).

IV. DISCUSSION

For the following reasons, the Court **GRANTS** default judgment and orders the following: (1) permanent injunction; (2) disgorgement in the amount of $7,210,000.00, together with prejudgment interest of $1,052,403.73; and (3) $150,000.00 in civil penalties against J. Lee.

A. Plaintiff Has Satisfied the Procedural Requirements for Default Judgment

Plaintiff has satisfied the procedural requirements for default judgment pursuant to Rule 55(b)(2) and Central District of California Local Rule 55-1. The Court makes the following findings:

- The Court has jurisdiction over this matter pursuant to sections 20(b), 20(d)(1) and 22(a) of the Securities Act, 15 U.S.C. §§ 77t(b), 77t(d)(1) and 77v(a), 15 U.S.C. §§ 78u(d)(1), 78u(d)(3)(A), 78u(e) and 78aa(a), and sections 21(d)(1), 21(d)(3)(A), 21(e) and 27(a) of the Exchange Act. (Compl. ¶ 1.)
- The clerk properly entered default as to the SEC's Complaint against the Entity Defendants and J. Lee on March 17, 2015 and August 7, 2015, respectively. (SEC's Mot., Matteson Decl. ¶¶ 3, 4.)
- Neither J. Lee nor the Entity Defendants are minors, incompetent persons, in military service, or otherwise exempted under the Servicemembers Civil Relief Act. (*Id.* ¶¶ 5-6.)
- Rule 55(b)(2)'s notice requirements do not apply here because neither J. Lee nor the Entity Defendants have appeared personally or by a representative in this action. (*Id.* ¶ 7.)

B. The *Eitel* Factors Weigh in Favor of Default Judgment

1. *Possibility of Prejudice to Plaintiff*

The Court first considers whether Plaintiff will suffer prejudice if default judgment is not entered. *Eitel*, 782 F.2d at 1471. Here, J. Lee, a major defendant in this case, is incarcerated in South Korea, and neither he nor the Entity Defendants have indicated that they will appear in this action. Further, the SEC pursues this action in the public interest and seeks disgorgement for the benefit of defrauded investors. Without default judgment, Plaintiff has no other recourse. Therefore, Plaintiff will suffer prejudice if default judgment was not entered.

2. *Merits of Plaintiff's Substantive Claims and Sufficiency of the Complaint*

The second and third *Eitel* Factors assess the substantive merits of Plaintiff's claims and the sufficiency of its pleadings. *Eitel*, 782 F.2d at 1471. To warrant default judgment, the allegations in the complaint must be sufficient to state a claim upon which a plaintiff can recover. *Danning v. Lavine*, 572 F.2d 1386, 1388 (9th Cir. 1978). In the instant action, the SEC asserts the following three claims: (1) violation of section 17(a) of the Securities Act (15 U.S.C. § 77q(a)); (2) violation of section 10(b) of the Exchange Act (15 U.S.C. § 78j(b)), and Rule 10b-5 thereunder; and (3) joint and several liability on the part of J. Lee under section 20(a) of the Exchange Act (15 U.S.C. § 78t(a)).

a. *Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5*

Section 17(a) of the Securities Act, section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder, prohibit fraud in the offer or sale, or in connection with the purchase or sale, of securities. 15 U.S.C. §§ 78q(a), 78j(b). To establish liability under these antifraud provisions, the SEC must show that the defendant (1) made a material misstatement or omission in connection with the offer, purchase, or sale of a security (2) with scienter. *S.E.C. v. Dain Rauscher, Inc.*, 254 F.3d 852, 856 (9th Cir. 2001).

i. *J. Lee and the Entity Defendants Made Material Misrepresentations and Omissions*

Information is material if "there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision." *Caravan Mobile Home Sales, Inc. v. Lehman Bros. Kuhn Loeb*, 769 F.2d 561, 565 (9th Cir. 1985). These antifraud provisions impose "a duty to disclose material facts that are necessary to make disclosed statements, whether mandatory or volunteered, not misleading." *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 504 (9th Cir. 1992).

Here, the facts establish that defendants misrepresented that the $11.5 million in investor monies was being used to construct and operate an ethanol plant in Kansas, that these investments qualified the investors to obtain U. S. residency citizenship, and that people had been employed for this venture. (Compl. ¶ 18.) Contrary to these misrepresentations, the ethanol plant was never built. Instead, J. Lee and R. Lee misappropriated and misused most of the $11.5 million. The misrepresentations and omissions were material because there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision.

ii. *The Statements and Omissions Were Made With Scienter*

Scienter refers to a "mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter is satisfied by recklessness. *Dain Rauscher, Inc.*, 254 F.3d at 856. "Reckless conduct is conduct that consists of a highly unreasonable act, or omission, that is an 'extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers [] that is either known to the defendant or is so obvious that the actor must have been aware of it.'" *Id*.

Here, the facts, deemed true, support a claim that J. Lee and the Entity Defendants[1] made these misrepresentations and omissions with the requisite scienter. J. Lee was the "architect" of the entire fraudulent scheme. He headed and controlled each of the Entity Defendants. (Compl. ¶ 8.) He signed the initial application to the USCIS for designation as a regional center in 2006 as President and CEO of Kansas Biofuel. (*Id.* ¶ 21.) J. Lee also provided offering materials to each investor, which represented that their money would be invested in Nexsun to develop and operate an ethanol plant. (*Id.* ¶ 25.) Further, J. Lee approved of all information regarding the purported Nexsun ethanol project that was disseminated at investor seminars from 2008 to 2010. (*Id.* ¶ 35.)

By 2009, preliminary construction of the ethanol plant ceased and construction of the ethanol plant was no longer feasible. Nevertheless, J. Lee continued to make representations to investors and the USCIS that construction of the plant was ongoing. (*Id.* ¶¶ 38, 41, 43.) The Court finds that these facts sufficiently establish the requisite scienter for liability under sections 17(a), 10(b), and 10b-5.

b. *Section 20(a) of the Exchange Act*

The SEC has also sufficiently pleaded J. Lee's joint and several liability under section 20(a) of the Exchange Act. Section 20(a) provides that "Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable[.]" 15 U.S.C. § 78t(a). In the Ninth Circuit, "the controlling person must have acted in bad faith and directly or indirectly induced the conduct constituting a violation or cause of action." *Strong v. France*, 474 F.2d 747, 752 (9th Cir. 1973).

Based on the facts deemed true, J. Lee induced the Entity Defendants' conduct and acted in bad faith. J. Lee was the control person of each of the Entity Defendants because he possessed, directly or indirectly, the power to direct or cause the direction of the management and policies of each of these entities. (Compl. ¶ 63.)

3. *Sum of Money At Stake In the Action*

Under the third *Eitel* Factor, "the court must consider the amount of money at stake in relation to the seriousness of Defendant's conduct." *PepsiCo, Inc. v. Cal. Sec. Cans*, 238 F. Supp. 2d 1172, 1176-77. "This requires that the court assess whether the recovery sought is proportional to the harm caused by the defendant's conduct." *Landstar Ranger*, 725 F. Supp. 2d at 921. The SEC seeks the following monetary relief: (1) disgorgement by J. Lee and the Entity Defendants, jointly and severally, of

[1]J. Lee's knowledge is imputed to the Entity Defendants which he controlled. *See SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1089, n.3 (2nd Cir. 1972) (when a defendant exercises blanket control over entities, those entities may be considered "corporate embodiments of [a defendant] and his awareness of the securities laws violations are imputed to them.").

$7,210,000.00, plus prejudgment interest of $1,052,403.73; and (2) a civil penalty of $150,000.00 against J. Lee.

Here, J. Lee and the Entity Defendants raised at least $11,455,000.00 by means of their fraudulent scheme. The SEC seeks disgorgement of the $7,210,000.00 which it has established was misappropriated or misused. Further, the SEC is seeking a relatively conservative $150,000.00 civil penalty only against J. Lee. Because the monetary relief that the SEC seeks is ill-gotten gain as opposed to penalty, and because public policy is advanced by granting the relief, this factor holds in favor of granting default judgment.

4. *The Possibility of a Dispute Concerning Material Facts*

The fifth *Eitel* Factor examines the likelihood of dispute between the parties concerning the material facts in the case. *PepsiCo*, F. Supp. 2d at 1177. Here, the SEC has supported its claims with sufficient facts, and J. Lee and the Entity Defendants have failed to appear in this action. Therefore, the likelihood of a dispute concerning material facts is minimal. Moreover, as a former attorney, J. Lee is presumably aware of the consequences of not answering. Therefore, this factor favors granting default judgment.

5. *Possibility of Excusable Neglect*

The sixth *Eitel* Factor considers the possibility that the defendant's default was a result of excusable neglect. *Landstar Ranger*,725 F. Supp. 2d at 922. Here, the possibility of excusable neglect is remote. The SEC properly served J. Lee and the Entity Defendants. Thus far, these defendants have failed to answer the Complaint, defend themselves against the allegations, oppose the SEC's requests for default, or seek relief from default. In light of the above, this factor favors entry of default judgment.

6. *Strong Policy Favoring Decisions on the Merits*

The final *Eitel* Factor examines the strong policy in favor of deciding cases on the merits. *Eitel*, 782 F.2d at 1472. Although "cases should be decided upon their merits whenever reasonably possible[,] Rule 55(a) allows a court to decide a case before the merits are heard if the defendant fails to appear and defend." *Landstar Ranger*, 725 F. Supp. 2d at 922. Here, defendants have failed to appear. Therefore, the policy favoring decisions on the merits is outweighed by the impracticability posed by the defendants' absence in this case.

In sum, all of the *Eitel* Factors weigh in favor of granting the SEC's Motion.

C. Plaintiff is Entitled to the Relief Sought

On default judgment, a plaintiff is required to provide proof of all damages sought in the complaint. *PepsiCo*, 238 F. Supp. 2d at 1175. The Court addresses each relief sought by Plaintiff.

1. *Injunctive Relief*

Section 20(b) of the Securities Act and section 21(d) of the Exchange Act authorize injunctions as a form of relief for an enforcement action brought by the SEC. 15 U.S.C. §§ 77t(b), 78u(d)(1). To obtain a permanent injunction, the SEC "ha[s] the burden of showing there [is] a reasonable likelihood of future violations of the securities laws." *S.E.C. v. Murphy*, 626 F.2d 633, 655 (9th Cir. 1980). "The existence of past violations may give rise to an inference that there will be future violations[.]" *Id*. In predicting the likelihood of future violations, the court must assess "the totality of the circumstances surrounding the defendant and his violations," and consider such factors as "(1) the degree of scienter

involved; (2) the isolated or recurrent nature of the infraction; (3) the defendant's recognition of the wrongful nature of his conduct; (4) the likelihood, because of defendant's professional occupation, that future violations might occur; (5) and the sincerity of his assurances against future violations (collectively, the "*Murphy* Factors"). *Id*.

Applying the *Murphy* Factors to this case, the Court finds that the evidence supports the SEC's claim for injunctive relief. As discussed above, the facts adequately support a finding that J. Lee acted with a high degree of scienter. He committed multiple violations over a span of several years and ultimately defrauded 24 people of more than $11 million. Further, there is no indication that future violations will not occur.

2. *Disgorgement*

"The district court has broad equity powers to order the disgorgement of 'ill-gotten gains' obtained through the violation of the securities laws." *S.E.C. v. First Pac. Bancorp*, 142 F.3d 1186, 1191 (9th Cir. 1998). The SEC "bears the ultimate burden of persuasion that its disgorgement figure reasonably approximates the amount of unjust enrichment," but once the SEC establishes that figure, "the burden shifts to the defendants to demonstrate that the disgorgement figure was not a reasonable approximation." *S.E.C. v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1096 (9th Cir. 2010).

Here, the SEC alleges that from March 2009 to April 2011, J. Lee and the Entity Defendants fraudulently raised at least $11,455,000.00 in investor funds. (Compl. ¶ 24.) The SEC seeks disgorgement of only $7,210,000.00, the amount that it reasonably approximated as being misused. To satisfy its burden, the SEC provided the declaration of Roger Boudreau, an SEC Senior Accountant who participated in the investigation of this action. (SEC's Mot., Boudreau Decl. ¶¶ 2, 4.) Boudreau reviewed more than five bankers' boxes worth of financial records, including bank documents, for the Entity Defendants that the SEC subpoenaed and obtained. (*Id*. ¶¶ 4-5.) Based on Boudreau's review of the records, he determined that the defendants misused at least $7,210,000.00 of the total investment funds on expenditures unrelated to the construction of an ethanol plant. (*Id*. ¶ 6.) The Court finds that this is a reasonable approximation of the investment funds that the defendants misused.

Further, the Court finds that the SEC is entitled to an award for prejudgment interest in the amount of $1,052,403.73. Disgorgement includes an award of prejudgment interest to "ensure that the wrongdoer does not profit from the illegal activity." *S.E.C. v. Cross Fin. Servs., Inc.*, 908 F. Supp. 718, 734 (C.D. Cal. 1995). Here, the SEC used the rate of interest found in 26 U.S.C. § 6621 to calculate the prejudgment interest on the $7,210,000.00 for the period from April 7, 2011 (the date of the final investment made) through October 26, 2015 (the noticed hearing date for this Motion). *See Platforms Wireless Int'l*, 617 F.3d at 1099.

3. *Civil Penalty*

Lastly, the SEC seeks a third-tier civil penalty of $150,000.00[2] against J. Lee. Section 20(d) of the Securities Act and section 21(d)(3) of the Exchange Act provide that a court may impose a civil penalty for a violation of the securities laws and that the amount "shall be determined by the court in light of the facts and circumstances." 15 U.S.C. §§ 77t(d), 78u(d)(3). The statutes provide that penalties should be assessed according to a three-tier system. *See id.* Third tier penalties, which are not to exceed $150,000.00 for a natural person, are available where the securities law violation "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and such violation

[2]As adjusted for inflation pursuant to the Debt Collection Improvement Act of 1996.

directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons." *Id*. Like a permanent injunction, civil penalties are designed to deter the wrongdoer from similar violations in the future; therefore, courts frequently apply the *Murphy* Factors to assess civil penalties. *S.E.C. v. mUrgent Corp.*, 2012 WL 630219, at *2 (C.D. Cal. Feb. 28, 2012); *S.E.C. v. Alpha Telcom, Inc.*, 187 F. Supp. 2d 1250, 1263 (D. Or. 2002).

Here, both requirements necessary for "third tier" civil penalties and the majority of the *Murphy* Factors are satisfied. J. Lee's fraudulent and manipulative practices directly resulted in more than $11 million worth of losses to 24 persons. Further, for the reasons discussed above, the *Murphy* Factors also weigh in favor of imposing a third-tier civil penalty. Lastly, a civil penalty of $150,000.00 is in line with Congress' intent to "achieve the dual goals of punishment of the individual violator and deterrence of future violations." *S.E.C. v. eConnect*, 2002 WL 34465925, at *5 (C.D. Cal. Dec. 2, 2002) (citing *S.E.C. v. Moran*, 944 F. Supp. 286, 296 (S.D. N. Y. 1996)). The Court finds that in light of the facts and circumstances of this case, a $150,000.00 civil penalty for J. Lee is warranted.

V. CONCLUSION

For the foregoing reasons, the Court **GRANTS** the SEC's Motion and, as provided in the concurrently issued proposed judgment, orders the following: (1) J. Lee and the Entity Defendants are permanently enjoined from violating section 17(a) of the Securities Act and section 10(b) of the Exchange Act, and Rule 10b-5 thereunder; (2) J. Lee and the Entity Defendants are liable for disgorgement of $7,210,000.00, with a prejudgment interest thereon in the amount of $1,052,403.73, for a total of $8,262,403.73; and (3) J. Lee is to pay a civil penalty of $150,000.00.

IT IS SO ORDERED.

_____ : _____

Initials of Preparer _____