[FINAL BRIEF]

No. 11-1082

ORAL ARGUMENT SCHEDULED FOR FEB. 6, 2012

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

DAN RAPOPORT,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of an Order of the
Securities and Exchange Commission

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

MARK D. CAHN
General Counsel

MICHAEL A. CONLEY
Deputy General Counsel

JACOB H. STILLMAN
Solicitor

JOHN W. AVERY
Deputy Solicitor

JEFFREY A. BERGER
Senior Counsel

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9040B
(202) 551-5112 (Berger)

CERTIFICATE AS TO PARTIES, RULING, AND RELATED CASES

A. PARTIES

The parties appearing before the Commission and this Court are listed in the petitioner's brief.

B. THE RULING UNDER REVIEW

The ruling at issue is *In the Matter of Centreinvest, Inc. et al.*, Order of the Commission Denying Motion to Set Aside Default Order, Admin. Proc. File No. 3-13304, Securities Exchange Act of 1934 Release No. 63744, 2011 SEC Lexis 231 (Jan. 20, 2011).

C. RELATED CASES

This case has not previously been before this Court (or any other). Counsel is not aware of any related cases currently pending in this Court (or any other).

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GLOSSARY

ALJ	Administrative Law Judge
Br. __	Petitioner's opening brief at page __
Chekholko	Vladimir Chekholko
CI-Moscow	OOO Centreinvest Securities
CI-New York	CentreInvest, Inc.
Division	The Division of Enforcement
Exchange Act	Securities Exchange Act of 1934
Herlyn	William Herlyn
OIP	Order Instituting Proceedings
R. __	Certified Index, document number __

No. 11-1082

UNITED STATES COURT OF APPEALS
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SECURITIES AND EXCHANGE COMMISSION,

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BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

JURISDICTIONAL STATEMENT

On December 8, 2008, the Securities and Exchange Commission initiated an administrative proceeding against petitioner Dan Rapoport pursuant to Sections 15(b), 21B, and 21C of the Securities Exchange Act of 1934, 15 U.S.C. 78*o*(b), 78u-2, 78u-3. Rapoport failed to answer the charges, and an Administrative Law Judge (ALJ) found Rapoport in default and imposed sanctions against him.

Rapoport filed a motion to set aside the default judgment pursuant to Commission Rule of Practice 155(b), which the Commission denied on January 20, 2011. Rapoport filed a timely petition for review on March 17, 2011. This Court has jurisdiction pursuant to Section 25(a) of the Exchange Act, 15 U.S.C. 78y(a).

COUNTERSTATEMENT OF THE ISSUES

The Commission charged that Rapoport violated Section 15(a) of the Exchange Act, 15 U.S.C. 78*o*(a), by effecting securities transactions for U.S. investors without registering as a broker-dealer. After Rapoport failed to answer these charges, an ALJ found Rapoport in default and imposed sanctions, including "second-tier" money penalties. Five months later, Rapoport moved to set aside the default judgment pursuant to Commission Rule 155(b). The Commission denied the motion without addressing Rapoport's proposed defenses or the prejudice caused by his conduct because it found that the default was willful, that the Rule 155(b) motion was untimely, and that the sanctions were just. The issues are:

(1) Whether the Commission, which is bound by its own procedural rules and not the Federal Rules of Civil Procedure, acted within its discretion when, given the circumstances of Rapoport's willful default and his untimely Rule 155(b) motion, it denied that motion without considering his proposed defenses or the prejudice caused by his conduct.

(2) Whether, even assuming that the Commission should have considered his proposed defenses and prejudice, not doing so was harmless error because he has not shown that Rule 15a-6 could exempt him from Section 15(a) and because his conduct increased the risk of evidentiary difficulties.

(3) Whether the Commission properly exercised its discretion when it found that the allegations against Rapoport, which are accepted as true on default, supported the ALJ's choice of sanctions, including money penalties.

REGULATIONS

Relevant regulations not included in the petitioner's addendum are reprinted in an addendum to this brief.

COUNTERSTATEMENT OF THE CASE

A. Nature of the Case

In December 2008, the Commission issued an Order Instituting Proceedings (OIP) against Rapoport and several other respondents, alleging that Rapoport's solicitation of U.S. investors violated Section 15(a) of the Exchange Act because he was not registered as a broker-dealer with the Commission. Rapoport resides in Russia, and because Russian authorities refuse to execute requests for service of process from the United States, the Commission's Division of Enforcement

(Division) filed a motion to direct service of the OIP through his U.S. attorney. The ALJ granted this motion and ordered Rapoport to answer by March 2, 2009.

Rapoport did not comply, and the ALJ entered a default judgment against him on July 31, 2009. Based on the OIP's allegations, which are accepted as true on default, the ALJ found that Rapoport violated Section 15(a). The ALJ barred Rapoport from associating with any broker-dealer, ordered him to cease and desist from further violations of Section 15(a), and demanded an accounting for determining disgorgement. Based on its finding that Rapoport's violation was "deliberate or reckless," the ALJ ordered Rapoport to pay $315,000 in second-tier money penalties. *See* Section 21B(b)(2) of the Exchange Act, 15 U.S.C. 78u-2(b)(2) (authorizing "Second Tier" penalties for any "act or omission" that involves a "deliberate or reckless disregard of a regulatory requirement").

Five months later, Rapoport moved to set aside the default judgment pursuant to Commission Rule of Practice 155(b). After the ALJ denied his motion, Rapoport filed a second Rule 155(b) motion directly with the Commission, as authorized by the rule. The Commission found that Rapoport did not show "good cause" to set aside the default because he did not present adequate reasons for failing to answer the OIP, because his Rule 155(b) motion was untimely, and because the sanctions were not unjust.

B. Section 15(a) requires broker-dealers to register with the Commission, subject to limited exemptions for foreign broker-dealers.

Section 15(a) of the Exchange Act makes it "unlawful for any broker or dealer" to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security * * * unless such broker or dealer is registered" with the Commission. 15 U.S.C. 78*o*(a). This registration requirement is a critical component of the broker-dealer regulatory system that Congress created; it is "of the utmost importance," *Regional Properties, Inc. v. Financial & Real Estate Consulting Co.*, 678 F.2d 552, 561 (5th Cir. 1982), because a broker-dealer plays a critical role "as an intermediary between customers and the securities markets," *Registration Requirements for Foreign Broker-Dealers*, 54 Fed. Reg. 30013, 30014 (Jul. 18, 1989) (*Rule 15a-6 Release*). Registration binds a broker-dealer "to abide by numerous regulations designed to protect prospective purchasers of securities, including standards of professional conduct, financial responsibility requirements, recordkeeping requirements, and supervisory obligations over broker-dealer employees." *Roth v. SEC*, 22 F.3d 1108, 1109 (D.C. Cir. 1994).

Because Section 15(a) covers "a wide range of activities involving investors and securities markets," the registration requirement is broadly construed. *Rule 15a-6 Release*, 54 Fed. Reg. at 30015. Broker-dealers must register if they solicit

investors; that is, if they are "regularly involved in communications with and recruitment of investors for the purchase of securities," *SEC v. George*, 426 F.3d 786, 797 (6th Cir. 2005), or participate in securities transactions "at key points in the chain of distribution." *Massachusetts Fin. Servs., Inc. v. SIPC*, 411 F. Supp. 411, 415 (D. Mass), *aff'd*, 545 F.2d 754 (1st Cir. 1976). In essence, registration is required when a broker-dealer makes "any affirmative effort intended to induce transactional business." *Rule 15a-6 Release*, 54 Fed. Reg. at 30017.

In 1989, the Commission adopted Rule 15a-6, which created "limited" and "conditional" exemptions from Section 15(a) for foreign broker-dealers doing business with U.S. investors. *Rule 15a-6 Release*, 54 Fed. Reg. at 30016, 30020. The rule contains exemptions for *unsolicited* transactions and *solicited* transactions effected through a registered broker-dealer that is affiliated with the foreign broker-dealer. *Id*. at 30020. The exemptions are subject to numerous conditions, including the requirement that the registered broker-dealer maintain records, that the foreign broker-dealer consents to service through the registered broker-dealer, and that the registered broker-dealer issue confirmations and safeguard funds. 17 C.F.R. 240.15a-6(a)(iii). While the Commission proposed amending Rule 15a-6 in 2008, it never adopted those changes. *Exemption of Certain Foreign Brokers or Dealers*, 73 Fed. Reg. 39182 (Jun. 27, 2008).

C. Statement of the Facts

The following facts are based on the OIP, as well as other record documents that were before the ALJ and the Commission. *See* 17 C.F.R. 201.155(a)(2) (for defaults, the Commission or an ALJ may rule "upon consideration of the record, including the [OIP], the allegations of which may be deemed to be true"). Record documents other than the OIP, while not expressly relied upon by the Commission in the order under review, are cited below in response to the proposed defense that Rapoport asserts in his opening brief.

1. The conduct alleged in the OIP occurred while Rapoport worked at a foreign broker-dealer (CI-Moscow) that was affiliated with a registered broker-dealer (CI-New York).

Rapoport violated Section 15(a) while working at OOO Centreinvest Securities (CI-Moscow), a Moscow-based broker-dealer specializing in thinly traded Russian equities. CI-Moscow, which was founded under Russia law, never registered with the Commission. JA 26–27 (¶¶ 1–2). CI-Moscow was affiliated with CentreInvest, Inc. (CI-New York), a Commission-registered broker-dealer based in New York. JA 27 (¶ 3); JA 152–53, 161 (¶¶ 6, 10). CI-New York was owned by Intelsa Investments Limited, a Cypriot entity. JA 28 (¶ 8).

When employees at CI-Moscow or CI-New York solicited U.S. investors to purchase or sell Russian securities, CI-Moscow executed the transaction and

performed "other administrative functions," as Rapoport concedes. Br. 3; JA 28 (¶ 10). These "functions" included issuing confirmations for transactions and maintaining custody of the securities and funds related to the transactions. JA 154–55 (¶¶ 14, 17–18), JA 192–99; JA 264–67 (¶¶ 14–24), JA 333–42; JA 374 (¶¶ 9–11); JA 398–99 (¶¶ 7–8); JA 367–68 (¶¶ 8–10). CI-New York did not maintain records concerning CI-Moscow's transactions with U.S. investors, even though CI-New York's officers had learned that this would disqualify CI-Moscow from a Rule 15a-6 exemption. JA 28, 30–32 (¶¶ 12–13, 23–25, 34–36).

2. Rapoport, who was a managing director at CI-Moscow, supervised the staff and sales efforts at both CI-Moscow and CI-New York.

Rapoport began working at CI-Moscow in 1995, and spent several years at CI-New York before returning to CI-Moscow in 2003. JA 27 (¶ 6). He served as managing director until he left CI-Moscow in early 2008. *Id*. In that role, Rapoport had significant responsibilities for CI-Moscow and CI-New York: he managed the sales operations and hired personnel for both entities; he approved the budget for CI-New York; and he decided compensation, including bonuses tied to transactions executed by CI-Moscow. JA 27–28 (¶¶ 4–7); JA 262, 264–65 (¶¶ 4, 15); JA 154 (¶ 15); JA 685–94. Rapoport also mediated disputes over sales leads,

deciding that CI-Moscow sales staff would solicit some U.S. investors. JA 269 (¶ 33), JA 356–59.

Between 2003 and 2007, Rapoport directly solicited U.S. investors to purchase Russian equities through CI-Moscow. JA 28 (¶¶ 9–11); JA 373–74 (¶¶ 5, 7–10), JA 377–96; JA 681–83. During the same time period, Rapoport also made other "affirmative efforts intended to induce transactional business," *Rule 15a-6 Release*, 54 Fed. Reg. at 30017, by directing CI-New York's and CI-Moscow's sales activities, JA 28–29 (¶¶ 9–10, 17). In particular, Rapoport told his staff to promote certain securities, circulated lists of U.S. investors to target, reviewed drafts of cold-call scripts and follow-up letters, and established call protocols, such as not leaving messages. JA 268 (¶¶ 26–27), JA 344–47; JA 155–57 (¶¶ 20–25), 202–55. CI-Moscow salespeople supervised by Rapoport also directly solicited U.S. investors even though they were not properly registered. JA 28 (¶ 14); JA 269 (¶¶ 31–32); JA 366-67(¶¶ 3–8).

D. Commission Proceedings

1. The Commission initiated proceedings against Rapoport in December 2008, and the ALJ ordered that service of the OIP be directed through Rapoport's U.S. counsel.

The Commission instituted proceedings against Rapoport (and several other respondents) on December 9, 2008.[1] Rapoport learned of the Division's investigation against him months earlier: he received a Wells Notice in July or August 2008, and retained Richard Kraut, a U.S. attorney, in early September 2008 to assist with a response. JA 587–605. Kraut communicated with Division counsel throughout the fall of 2008 regarding the investigation. *Id*.

A week after the Commission issued the OIP, the Division, invoking Rule of Practice 141, filed a motion requesting permission to direct service of the OIP through Kraut. The Division sought this relief because Rapoport was a Russian resident, and the Russian authorities through which requests for service must proceed refused all such requests originating from the United States. *Arista Records LLC v. Media Servs. LLC*, 2008 U.S. Dist. Lexis 16485, at *7 (S.D.N.Y. Feb. 25, 2008). The Division argued that directed service was appropriate under

[1] The proceedings have concluded with respect to all other respondents. Exchange Act. Rel. No. 61448 (Jan. 29, 2010) (CI-Moscow), No. 60485 (Aug. 12, 2009) (Herlyn), No. 60450 (Aug. 5, 2009) (Chekholko), No. 60413 (July 31, 2009) (CI-New York and Yenin).

these circumstances and was "reasonably calculated to give notice" since Kraut had already represented Rapoport for several months. JA 118–20; JA 1164–65; 17 C.F.R. 201.141(a)(2)(iv) (stating that notice to "a person in a foreign country" may be made 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"). Kraut opposed the Division's motion on Rapoport's behalf.

The ALJ granted the motion on February 5, 2009, directing service of the OIP through Kraut and ordering Rapoport to answer by March 2, 2009. JA 118–20. At a status conference with the ALJ held on February 5, Kraut represented that he would bring the order directing service to Rapoport's attention. JA 113. Kraut also stated his understanding that his representation of Rapoport "terminated upon the issuance" of that order. *Id.* But Kraut did not seek to withdraw as counsel until February 12, JA 124, and his withdrawal was effective no earlier than February 17. *Compare* Br. 8 (claiming that withdrawal was "effective February 5") *with* 17 C.F.R. 201.102(d)(4) (requiring notice to be filed "at least five days before the proposed effective date of withdrawal").

2. After Rapoport failed to file a timely answer, the ALJ imposed sanctions on Rapoport by default.

Rapoport did not file an answer by March 2, even though the OIP warned that such conduct could result in default, in which case the ALJ could "find the allegations in the OIP to be true, and order the relief requested by the Commission." JA 33. The ALJ sent orders regarding scheduling and conferences—as well as the default order discussed below—to the address of another Moscow brokerage firm where Rapoport worked through September 2009, but Rapoport did not contact the ALJ or otherwise appear to defend the proceeding. JA 714; JA 1166 n.13.

The Division moved for a default judgment on April 8, 2009, a month after Rapoport failed to file a timely answer. R.37–38, citing 17 C.F.R. 201.155(a), 220(f) ("If a party respondent fails to file an answer required by this section within the time provided, such person may be deemed in default pursuant to Rule 155(a)."). The ALJ granted the motion almost four months later on July 31, 2009. Accepting the OIP allegations as true, the ALJ found that Rapoport knowingly violated Section 15(a) and was not exempt under Rule 15a-6. JA 457–58, 461. The ALJ further found that Rapoport's misconduct was willful and recurring, and

that, because he did not defend the proceeding, he neither assured against future violations nor acknowledged his misconduct. JA 463.

Based on these findings, the ALJ ordered Rapoport to cease and desist from further violations of Section 15(a) and barred him from association with any broker-dealer. JA 463–64. Because Rapoport did not provide any information concerning ill-gotten gains for purposes of determining disgorgement, the ALJ ordered him to provide an accounting of his 2003–2008 income. JA 465. Finding that Rapoport deliberately or recklessly disregarded Section 15(a), the ALJ imposed second-tier penalties corresponding to one violation for each of the five years from 2003 through 2007. The ALJ imposed the maximum penalty for each violation—$60,000 for acts that occurred in 2003–2005, and $65,000 for acts that occurred in 2006 and 2007. JA 466–67, citing Section 21B(b)(2) of the Exchange Act, 15 U.S.C. 78u-2(b)(2), as corrected by JA 726.

3. Rapoport moved to set aside the default judgment pursuant to Commission Rule of Practice 155(b).

Five months later, Rapoport, represented by his current counsel, moved to set aside the default judgment. In his initial Rule 155(b) motion, filed on December 23, 2009, Rapoport claimed that "good cause" existed because he was not obligated to answer the OIP until he was personally served. JA 484–512. He

claimed that this did not occur until October 23, 2009, when U.S. Customs officials detained him as he attempted to enter the United States and handed him the OIP. R.64–65; *but see* JA 983–85 (Customs official at JFK Airport declaring that he handed Rapoport the default judgment, not the OIP).

The ALJ denied Rapoport's motion on March 22, 2010, finding that Rapoport had "failed to present 'good cause'" to set aside the default judgment. JA 716. The ALJ also refused to set aside the sanctions, although it agreed that the default judgment order incorrectly summed the penalties. JA 725–26. The ALJ remedied this clerical error, revising the order to reflect the correct total of $315,000. JA 726.

Rapoport then filed a Rule 155(b) motion directly with the Commission, as allowed under the rule. The Commission denied Rapoport's motion on January 20, 2011, finding that good cause did not exist to set aside the default judgment.[2] The Commission rejected Rapoport's reasons for failing to answer, finding "that Rapoport could not reasonably have believed that he could wait to respond until he

[2] Rapoport alternatively styled his motion as a petition for review of the ALJ's decision, but the Commission's denial of the Rule 155(b) motion made "it unnecessary to address separately Rapoport's petition for review." JA 1167 n.20. While Rapoport asserts that the Commission denied oral argument "without explanation," Br. 11, the Commission did provide an explanation in a written order, stating its view that "the decisional process" would not be "significantly aided by oral argument in this case." JA 1161.

was personally served" because "Rapoport knew that [the ALJ] had authorized service on him through Kraut." JA 1167, 1169. The Commission further found that Rapoport's motion to set aside was not filed "'within a reasonable time,'" as required by Rule 155(b), because he filed his motion "almost five months after the Default Order was issued and mailed to him." JA 1171. The Commission did not evaluate Rapoport's proposed defenses, stating that "[e]valuating the merits of his defenses would in effect grant him the hearing that he chose to forego by failing to defend the proceeding." JA 1172.

The Commission disagreed that the sanctions imposed by the ALJ were unjust. In response to Rapoport's contention that the OIP did not support sanctions for 2003–2005, the Commission found that the OIP indeed charged Rapoport with violating Section 15(a) during that time. Moreover, the Commission disagreed that the penalties were "'legally impermissible and factually unwarranted'" because it found that there were sufficient allegations to support the imposition of second-tier penalties, as well as the rest of the sanctions. JA 1172–73 & n.32.

STANDARD OF REVIEW

Under Commission Rule 155(b), the Commission "may for good cause shown set aside a default." 17 C.F.R. 201.155(b). Courts, including this one, apply an abuse-of-discretion standard when they review agency decisions declining

to reopen or reconsider matters for failure to show "good cause." *E.g.*, *Bowman Transp. Inc. v. Arkansas-Best Freight Sys., Inc.*, 419 U.S. 281, 295–96 (1974); *Eastern Carolinas Broadcasting v. FCC*, 762 F.2d 95, 103 (D.C. Cir. 1985).[3] This standard is particularly fitting given that Rule 155 uses the word "may," which confers discretion. *Zhu v. Gonzales*, 411 F.3d 292, 296 (D.C. Cir 2005). Moreover, although Federal Rule of Civil Procedure 55(c) does not apply here, it is notable that this Court reviews Rule 55(c) decisions under the same, highly deferential standard. *Mohamad v. Rajoub*, 634 F.3d 604, 606 (D.C. Cir. 2011).

The Commission's determination that the sanctions imposed by the ALJ were not unjust is also reviewed for an abuse of discretion because the Commission's "choice of remedy is peculiarly a matter for administrative competence," and this Court "will reverse it only if the remedy chosen is "'unwarranted in law or * * * without justification in fact.'" *Wonsover v. SEC*, 205 F.3d 408, 413 (D.C. Cir. 2000), *quoting Butz v. Glover Livestock Comm'n*, 411 U.S. 182, 185–86 (1973) (omission in original). This Court accords "great

[3] *Accord Umezurike v. Holder*, 610 F.3d 997, 1001–02 (7th Cir. 2010) (reviewing agency decision denying motion to reopen proceedings for abuse of discretion); *Zamot v. Merit Sys. Protection Bd.*, 332 F.3d 1374, 1377 (Fed. Cir. 2003) (decision whether to waive time limit for "good cause" is committed to agency discretion); *NLRB v. USA Polymer Corp.*, 272 F.3d 289, 296 (5th Cir. 2001) ("The Board's action in finding lack of good cause based on excusable neglect is reviewed for abuse of discretion.").

deference to the SEC's decisions as to choice of sanction." *Seghers v. SEC*, 548 F.3d 129, 135 (D.C. Cir. 2008) (internal quotation marks omitted).

SUMMARY OF ARGUMENT

The Commission acted within its discretion when it found that Rapoport did not show "good cause" to set aside the default judgment because he did not explain his failure to answer the charges against him and did not file his Rule 155(b) motion within a reasonable time. The Commission's decision not to reach the "meritorious defense" and "prejudice" factors considered by some courts applying Federal Rule of Civil Procedure 55(c) was not erroneous because Commission Rule 155(b)—and not federal Rule 55(c)—governs Commission proceedings. This Court should defer to the Commission's interpretation that Rule 155(b) does not compel consideration of proposed defenses and prejudice when a default is willful or when a Rule 155(b) motion is untimely, as was the case here.

In any event, the "meritorious defense" and "prejudice" factors would not support setting aside the default judgment. Rapoport claims an exemption from Section 15(a)'s registration requirement under Rule 15a-6, but he merely asserts that the rule applies without any showing that its many conditions have been satisfied here. Moreover, Rapoport has not demonstrated that the increased risk of lost evidence would not prejudice the Division.

The Commission also properly exercised its discretion when it upheld the sanctions imposed by the ALJ. Contrary to Rapoport's assertion, the Commission adequately explained its reasons for concluding that the sanctions were appropriate. In its order, the Commission cited allegations in the OIP, taken as true on default, charging that Rapoport deliberately and recklessly violated Section 15(a)—the requisite scienter for second-tier penalties—from 2003 to 2007. While Rapoport tries to portray the sanctions as excessive by labeling Section 15(a) an "arcane registration requirement," Section 15(a) is the keystone of the entire broker-dealer regulatory system.

ARGUMENT

I. The Commission acted within its discretion when it applied Rule 155(b) and found that Rapoport did not show "good cause" to set aside the default, regardless of any other factors such as his proposed defenses, because he did not explain his failure to answer the charges against him or file his motion in a timely fashion.

Rapoport claims that the Commission erred because its order was inconsistent with Federal Rule of Civil Procedure 55(c). The Commission, however, is bound by its own procedural rule, not Rule 55(c), and this Court should defer to the Commission's view that a default judgment may be upheld regardless of any proposed defenses where "good cause" is not otherwise shown. Because Rapoport did not justify his failure to answer or file his Rule 155(b)

motion within a reasonable time, the Commission properly determined that "good cause" did not exist to set aside the default judgment.

A. Rule 155(b), not federal Rule 55(c), is controlling.

Rapoport proceeds from the faulty premise that the Commission must follow Federal Rule of Civil Procedure 55(c). Br. 16–19. But, as its name implies, that rule applies only to federal district courts; "agencies need not observe all the rules and formalities applicable to courtroom proceedings." *McClelland v. Andrus*, 606 F.2d 1278, 1286 (D.C. Cir. 1979); *see also* FED. R. CIV. PROC. 1 ("These rules govern the procedure in all civil actions and proceedings in the United States district courts.").[4] Instead, an agency is "free to fashion [its] own rules of procedure," *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519, 544 (1978), and to tailor those rules "to the peculiarities of the industry and the tasks of the agency involved," *FCC v. Schreiber*, 381 U.S. 279, 290 & n.19 (1965). Precisely because an agency is "master of its own house," *NRDC v. SEC*, 606 F.2d 1031, 1056 (D.C. Cir. 1979), "it is too well-established to be seriously questioned

[4] *Accord Mister Discount Stockbrokers, Inc. v. SEC*, 768 F.2d 875, 878 (7th Cir. 1985) ("Neither the Federal Rules of Civil Procedure nor the Federal Rules of Criminal Procedure apply to administrative hearings * * * ."); *FTC v. Turner*, 609 F.2d 743, 745 n.3 (5th Cir. 1980) ("[T]he Federal Rules of Civil Procedure do not bind administrative agencies in conducting purely administrative investigations."); *Title Guar. Co. v. NLRB*, 534 F.2d 484, 487 (2d Cir. 1976) (stating that the federal rules have no bearing on the NLRB's discovery procedures).

that agencies are empowered to order their own proceedings and control their own dockets." *Association of Bus. Advocating Tariff Equity v. Hanzlik*, 779 F.2d 697, 701 (D.C. Cir. 1985).

The Commission adopted such procedural rules in 1995, and it addressed defaults in Rule 155. *Rules of Practice*, 60 Fed. Reg. 32738, 32752 (Jun. 23, 1995). The Commission did so pursuant to its "inherent powers" to "control its own docket," as well as authority granted by Congress. *GTE Service Corp. v. FCC*, 782 F.2d 263, 274 n.12 (D.C. Cir. 1986); Section 23(a)(1) of the Exchange Act, 15 U.S.C. 78w(a)(1).[5] Contrary to Rapoport's assertion, the Commission is bound only by Rule 155—neither application of Rule 55(c) nor consideration of the "three-factor balancing test" used by some federal courts applying Rule 55(c) is "mandatory" for the Commission. Br. 13, 16–18.

[5] Unlike with other rules adopted in 1995, the Commission did not pattern Rule 155 on federal Rule 55(c) or any other federal rule. *Compare Rules of Practice*, 60 Fed. Reg. 32738, 32752 (Jun. 23, 1995) *with id.* at 32760 (stating that Rule 220, regarding answers, is based on Federal Rules of Civil Procedure 8 and 12). Rule 155(b) retained the "good cause" standard articulated in prior default rules, which were also adopted without reference to the federal rules. *See Amendments to Rules with Respect to Default Procedures*, 1964 SEC Lexis 92, at *11–12 (Jun. 30, 1964) (creating former Rule 12(d)); *Rules of Procedure*, 58 Fed. Reg. 61732, 61741 (Nov. 22, 1993) (moving former Rule 12(d) to former Rule 9(g)).

B. The Commission's interpretation of "good cause," as used in Rule 155(b), merits substantial deference.

Under the Commission's interpretation of its own rule, presentation of proposed defenses is a necessary, but not sufficient, condition to their consideration. A Rule 155(b) motion must specify "the nature of the proposed defense," "be made within a reasonable time," and "state the reasons for the failure to appear or defend." 17 C.F.R. 201.155(b). But, as this case demonstrates, the Commission has declined to consider proposed defenses when defaulting parties cannot justify their failure to answer or do not timely move to set aside the default. JA 1172; *In re Hellen*, 55 S.E.C. 248 (2001); *In re Ainbinder*, 1997 SEC Lexis 2062 (Oct. 1, 1997); *In re Bullard*, 1995 SEC Lexis 3049 (Nov. 9, 1995); *In re Richards*, 1994 SEC Lexis 2663 (Aug. 29, 1994).

The Commission's interpretation of its own rules receives "the highest level of deference," *Intermountain Ins. Serv. of Vail v. Comm'r*, 650 F.3d 691, 708 (D.C. Cir. 2011), and must be upheld unless it is "plainly erroneous or inconsistent with the regulation," *Auer v. Robbins*, 519 U.S. 452, 461 (1997); *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945). Because Rule 155(b) is procedural, this deference is at its apex. *Blackmon-Malloy v. United States Capitol Police Bd.*, 575 F.3d 699, 710 (D.C. Cir. 2009); *Schreiber*, 381 U.S. at 290–91 ("Congress has

not empowered" courts "to substitute their judgment for" an agency's interpretation of its own procedural rule); *Kornman v. SEC*, 592 F.3d 173, 181–82 (D.C. Cir. 2010) (deferring to the Commission's interpretation of Rule 250).

The Commission's interpretation of Rule 155(b) is consistent with the rule and must be upheld. Nothing in the rule text compels the Commission to analyze proposed defenses after it finds that a default was willful or a Rule 155(b) motion was untimely. Nor does Rule 155(b) define "good cause" in a way that would mandate such analysis, in large part because that term "is not susceptible of precise definition." *In re Dierschke*, 975 F.2d 181, 183 (5th Cir. 1992).

Rapoport does not suggest that the Commission's interpretation is somehow inconsistent with Rule 155, arguing instead that the Commission acted "contrary to settled law" because it did not analyze all three factors of a test cited by courts interpreting Rule 55(c). Br. 18. Interpretations of Rule 55(c), however, are not binding here, and the law concerning Rule 55(c) is not nearly as "settled" as Rapoport claims. The decisions of this Court that he cites do not hold that failure to consider proposed defenses is error under all circumstances. *Keegel v. Key West & Carribean Trading Co.*, 627 F.2d 372 (D.C. Cir. 1980); *Jackson v. Beech*, 636 F.2d 831, 835 (D.C. Cir. 1980). Rather, in each case, the Court reversed district courts that failed to analyze any factors, including willfulness. *Keegel*, 627 F.2d at

374 ("Consideration of the [three] criteria is not reflected in the district court's memorandum."); *Jackson*, 636 F.2d at 837 (criticizing the district court for not considering any of the factors). In other cases, this Court affirmed decisions denying Rule 55(c) motions without any discussion of proposed defenses. *Hughes v. Holland*, 320 F.2d 781, 782 (D.C. Cir. 1963); *Draisner v. Liss Realty Co.*, 211 F.2d 808, 809 (D.C. Cir. 1954).

Decisions like *Hughes* and *Draisner* demonstrate that the three-factor test is "not talismanic." *Dierschke*, 975 F.2d at 184. Rather, when a court finds that a defendant intentionally failed to answer, "there need be no other finding" because wilfulness "alone may constitute sufficient cause" to deny a Rule 55(c) motion. *Dierschke*, 975 F.2d at 184–85. It is precisely because "'[g]ood cause' is a mutable standard, varying from situation to situation," *Compania Interamericana Export-Import v. Compania Dominicana de Aviacion*, 88 F.3d 948, 951 (11th Cir. 1996), that federal courts applying Rule 55(c) have assigned willfulness greater weight—and sometimes dispositive weight—in comparison to the other two factors, *Coon v. Grenier*, 867 F.2d 73, 76 (1st Cir. 1989). The Commission's interpretation of Rule 155(b) can hardly be erroneous when it accords with the

decisions of numerous courts that have declined to consider other factors after finding that a default was willful.[6]

C. The Commission properly exercised its discretion when it found that there was no "good cause" because Rapoport did not justify his conduct or file his motion within a reasonable time.

1. Rapoport has not offered any reasonable explanation for his failure to file an answer as ordered.

Rapoport did not justify his conduct to the Commission, and he provides no reasonable explanation here. He dedicates only two paragraphs of his brief to this issue, citing inapplicable Rule 55(c) decisions and contending that the Commission did not account for "mitigating factors" or "resolve doubts in Rapoport's favor." Br. 21–22. The record, however, leaves no doubt that Rapoport lacked an acceptable reason for failing to file an answer by March 2.

Rapoport learned about the Division's investigation no later than August 2008, when he received the Wells Notice that prompted him to retain his attorney, Kraut, and he learned about the OIP no later than December 2008, when he asked

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[6] Appellate decisions affirming a Rule 55(c) denial without consideration of defenses include, in addition to those cited in the text, *Guttman v. Silverberg*, 167 Fed. Appx. 1 (10th Cir. 2005) (unpublished); *KPS & Assocs. v. Designs by FMC, Inc.*, 318 F.3d 1, 12 (1st Cir. 2003); *American Ass'n of Naturopathic Physicians v. Hayhurst*, 227 F.3d 1104 (9th Cir. 2000); *Gucci Am., Inc. v. Gold Ctr. Jewelry*, 158 F.3d 631 (2d Cir. 1998); *Waifersong, Ltd. v. Classic Music Vending*, 976 F.2d 290 (6th Cir. 1992); *United States v. 3,888 Lbs. Atlantic Sea Scallops*, 857 F.2d 46 (1st Cir. 1988).

Kraut to oppose the Division's motion for directed service. JA 587–605; JA 518–19 (¶¶ 14–16). When the ALJ ordered Rapoport to answer by March 2, Kraut said that he would bring that order to Rapoport's attention, JA 116–20; JA 113, and Rapoport has never produced an affidavit in which Kraut denies notifying him, JA 1169 n.25. Thus, despite knowing about the investigation and the OIP—and, as the Commission found, knowing about the order directing service and the March 2 deadline—Rapoport did not answer, even though he had been warned that default could result.

If Rapoport did not know about that March 2 deadline, as he implies, his ignorance was intentional. Br. 21–22. It defies belief that Rapoport ordered Kraut to oppose the Division's motion but never learned the outcome, although Rapoport's arrangement with Kraut suggests this, in fact, may have been the objective: Rapoport hired Kraut to oppose directed service "with the understanding that Kraut would cease to represent [him] after he filed those legal papers." JA 518–19 (¶ 16); *see also* Br. 8 (reiterating this arrangement). Rapoport thus admits that he hired Kraut to oppose directed service, but planned to terminate the representation if the ALJ directed service through Kraut. This should be construed as a blatant (albeit futile) attempt to avoid service that deprives Rapoport of the benefit of any purported doubt. Br. 22.

Rapoport's claimed belief that only personal service triggered his duty to respond is equally unconvincing. Br. 21. If Rapoport had believed only personal service would be effective, there would have been no need to oppose the Division's motion. JA 1169 ("Rapoport's active engagement in arguing against directed service is inconsistent with his asserted belief that he did not have to respond unless personally served."). In any event, Rapoport's belief has no legitimate basis because Rule 141 permits service by any "method reasonably calculated to give notice." 17 C.F.R. 201.141(a)(2)(iv). Rapoport has never denied knowing about the OIP or claimed that service through Kraut would have been insufficient to give notice. JA 1171 n.30 (noting that Rapoport did not dispute that he received actual notice of the OIP).

Rapoport's belated decision to defend himself is not a "mitigating factor." Br. 21–22. If the mere act of filing a Rule 155(b) motion were enough to justify setting aside the default judgment, there would be no need to consider willfulness (or any of the other factors cited by Rapoport). Rule 155(b)—and Rule 55(c) for that matter—require more: the desire to avoid the consequences of a default judgment does not make the conduct that led to the default judgment less willful. Rapoport's reappearance nearly ten months after he missed the deadline to answer—perhaps upon the realization that the sanctions and any federal judgments

executing on those sanctions would remain in force the next time he visited the U.S.—does not justify his refusal to answer in the first place.

Rapoport points to purported errors in the ALJ's application of Rule 141 as an excuse (Br. 8, 22 & nn.5, 13), but Rapoport did not raise this argument before the Commission, and he has thus waived it. Section 25(c)(1) of the Exchange Act, 15 U.S.C. 78y(c)(1). The ALJ's ruling was proper in any event: Rule 141 authorizes alternative service, such as directed service, on foreign respondents so long as it is not "prohibited by the law" of their home country. 17 C.F.R. 201.141(a)(2)(iv). Rapoport has never demonstrated that Russian law prohibited service through Kraut. To the contrary, federal courts have ordered directed service through counsel for Russian litigants—regardless of whether counsel is authorized to accept service—without any suggestion that doing so violates Russian law. *Nuance Communs., Inc. v. Abbyy Software House*, 626 F.3d 1222, 1239 (Fed. Cir. 2010); *accord Arista Records*, 2008 U.S. Dist. Lexis 16485, at *8–10; *RSM Prod. Corp. v. Fridman*, 2007 U.S. Dist. Lexis 58194, at *8–18 (S.D.N.Y. Aug. 10, 2007); *Forum Fin. Group v. President & Fellows of Harvard College*, 199 F.R.D. 22, 24–25 (D. Me. 2001).[7]

[7] Unlike Rule 155, Rule 141 was expressly patterned after a federal rule, namely Federal Rule of Civil Procedure 4(f). *Rules of Practice*, 60 Fed. Reg. at 32750.

2. *Rapoport did not file his Rule 155(b) motion within a reasonable time because he waited five months to seek relief.*

Although Rapoport does not mention it in his brief, the Commission denied his Rule 155(b) motion in part because it was untimely. JA 1171. Rapoport did not seek relief until December 23, 2009, almost five months after the July 31 default judgment, and the Commission did not err when it found that this gap was unreasonable. *Compare In re Hellen*, 55 S.E.C. 248, 251 (2001) (finding that a 10-month gap was not "reasonable" and denying motion) *with In re RDM Sports Group*, 2009 SEC Lexis 3631, at *4–5 (Nov. 3, 2009) (finding that an 11-day gap was "reasonable" but denying motion on other grounds). While cases interpreting what constitutes a "reasonable time" under the federal rules are not binding here, it is instructive that many courts consider five-month gaps (or less) to be unreasonable.[8]

Rapoport overstates his promptness when he asserts, in connection with other arguments in his brief, that he filed his Rule 155(b) motion "almost

[8] *SEC v. Simmons*, 241 Fed. Appx. 660, 664 (11th Cir. 2007) (unpublished) (per curiam) (four-month delay); *Kagan v. Caterpillar Tractor Co.*, 795 F.2d 601, 610–11 (7th Cir. 1986) (four-month delay); *American Metals Service Export Co. v. Ahrens Aircraft, Inc.*, 666 F.2d 718, 721 (1st Cir. 1981) (five-month delay); *Security Mut. Cas. Co. v. Century Cas. Co.*, 621 F.2d 1062, 1067–68 (10th Cir. 1980) (four-month delay); *Central Operating Co. v. Utility Workers of Am.*, 491 F.2d 245, 253 (4th Cir. 1974) (four-month delay).

immediately" after receiving the default judgment order on October 23, 2009. Br. 21. The relevant time period is the gap between the default judgment in July 2009 and the Rule 155(b) motion in December 2009, *cf. Jones v. Phipps*, 39 F.3d 158, 165 (7th Cir. 1993), but even by Rapoport's measure, he did not file his Rule 155(b) motion until *two months* after he received the default judgment order and he does not explain why he did not file sooner given what was at stake.

The existence of this five-month gap also indicates that Rapoport apparently made no effort to monitor the Commission proceeding. He knew about the OIP's existence by December 2008, and even after Kraut withdrew in February 2009, the ALJ sent case documents, including the default judgment order, to Rapoport at the address of the firm that employed him through September 2009. JA 714; JA 1166 n.13. Yet, Rapoport claims to have remained ignorant of the proceedings and the default judgment until October 2009. It was, at the very least, reckless for Rapoport to believe that the proceeding would just go away, and his decision to ignore matters until late December 2009 further supports the Commission's finding that he did not seek relief "within a reasonable time." *Cf. Spika v. Village of Lombard*, 763 F.2d 282, 285–86 (7th Cir. 1985) (reversing order granting relief from default judgment because movant failed to check case status for six months).

II. Even if the Commission were required to consider the "meritorious defense" and "prejudice" factors, and balance them against the willful nature of Rapoport's default and the untimeliness of his Rule 155(b) motion, the Commission's failure to do so was harmless because his only proposed defense lacks merit and his conduct was prejudicial.

A. Rapoport has not shown that his proposed defense—an exemption under Rule 15a-6—has any merit.

Rapoport has not demonstrated that Rule 15a-6 would "'constitute a complete defense.'" Br. 19, quoting *Keegel*, 627 F.2d at 374. To begin with, Rapoport misunderstands Rule 15a-6, which exempts conduct by foreign broker-dealers that otherwise would be illegal under Section 15(a). It is not the Commission's responsibility, as Rapoport urges, to allege "how or why Rapoport's conduct failed to meet the exemptions." Br. 6. Rather, it is Rapoport's responsibility to prove that Rule 15a-6 exempts otherwise illicit conduct. *See SEC v. Ralston Purina*, 346 U.S. 119, 126 (1953); *Zacharias v. SEC*, 569 F.3d 458, 464 (D.C. Cir. 2009) (a defendant has the burden to prove an exemption from a registration requirement imposed by Section 5 of the Securities Act of 1933).

Rapoport has not satisfied this burden. Showing compliance with a rule that he describes as "complex" implies a need to provide at least some detailed allegations or facts, but Rapoport presents his defense in a single paragraph that simply quotes selected parts of the rule. Br. 6, 19. He does not show how any of

the rule's four exemptions apply to any particular transaction. And he does not show that all the conditions necessary for those exemptions have been satisfied here. He simply invokes the rule, which is precisely the type of conclusory assertion, devoid of evidence and factual support, that is insufficient to show a meritorious defense. *Lepkowski v. United States Dep't of Treasury*, 804 F.2d 1310, 1314 (D.C. Cir. 1986); *Enron Oil Corp. v. Diakuhara*, 10 F.3d 90, 98 (2d Cir. 1993).[9] As just one example, Rapoport quotes Rule 15a-6(a)(4), which exempts transactions with various categories of investors, but he does not state that the investors solicited in this case fit into any of those categories, let alone cite supporting evidence. 17 C.F.R. 240.15a-6(a)(4)(ii), (iv).

The record before the Commission, as well as Rapoport's own assertions, demonstrate that no exemption is available. Rapoport cites Rule 15a-6(a)(2) and 15a-6(a)(3), which govern solicited transactions with U.S. investors, but for those exemptions to apply, a foreign-broker dealer must effect the transactions through a

[9] *Accord New York v. Green*, 420 F.3d 99, 110 (2d Cir. 2005) ("[A] 'defendant must present more than conclusory denials when attempting to show the existence of a meritorious defense.'"); *United States v. Kayser-Roth Corp.*, 272 F.3d 89, 95 (1st Cir. 2001) ("Purely conclusory allegations are not sufficient to establish" a defense); 10A Charles Alan Wright & Arthur R. Miller, FED. PRAC. & PROC. § 2697, at 160 (2d ed. 2002) (courts "have refused to accept general denials or conclusory statements that a defense exists; they have insisted upon a presentation of some factual basis for the supposedly meritorious defense").

registered broker-dealer, and that registered broker-dealer must, among other things, issue confirmations and safeguard funds and securities. 17 C.F.R. 240.15a-6(a)(2)(iii), (a)(3)(iii)(A)(1),(2), (6). Yet, Rapoport concedes that CI-Moscow executed all transactions with U.S. investors, and the record indicates that CI-Moscow—not CI-New York—issued confirmations and held custody of securities and funds. Br. 3; JA 28(¶ 10); JA 154–55 (¶¶ 14, 17–18), JA 192–99; JA 264–68 (¶¶ 14–24), JA 333–42; JA 374(¶¶ 9–11); JA 398–99 (¶¶ 7–8); JA 367–68 (¶¶ 8–10).

Rapoport stresses that CI-New York advised the Commission about this relationship with CI-Moscow, but CI-New York did no such thing. Br. 3–4, 31 n.22. While mere disclosure to the Commission would not somehow absolve Rapoport or establish an exemption where none otherwise exists, the filings that he cites merely reported CI-New York's audited financial statements and did not mention CI-Moscow, let alone hint that U.S. investors completed transactions through CI-Moscow.[10] Rapoport rhetorically asks why CI-New York would have disclosed its arrangement with CI-Moscow if it were improper (Br. 31 n.22), and the answer is simple: no such disclosure was made.

[10] Rapoport changes the meaning of the filings (and the ALJ's quotation) by inserting "CI-Moscow" in brackets after the word "Parent." Br. 31 n.22. The filings contain no reference to "CI-Moscow"; they define the "Parent" as Intelsa.

The battle over service in this case further demonstrates why an exemption is not available. For an exemption under Rule 15a-6(a)(2) or (3), Rapoport would have needed to give "written consent to" service through CI-New York for any Commission proceeding. 17 C.F.R. 240.15a-6(a)(3)(iii)(D). Had Rapoport given such consent, the skirmish regarding directed service would have been unnecessary, and far from claiming that he gave such consent, Rapoport insists that he did not have to defend the OIP until he was personally served. Br. 21.

Other prerequisites have not been shown. The exemption for unsolicited transactions (Rule 15a-6(a)(1)) does not apply because Rapoport was "regularly involved in communications with and recruitment of investors for the purchase of securities," *SEC v. George*, 426 F.3d 786, 797 (6th Cir. 2005), and made "affirmative effort[s] intended to induce transactional business," *Rule 15a-6 Release*, 54 Fed. Reg. at 30017, through direct contact with U.S. investors and his supervision of the New York and Moscow sales staffs. *See supra* pp. 8–9.

The exemptions for solicited transactions under Rule 15a-6(a)(2) and (3) are also not available here because CI-New York (as the registered broker-dealer affiliate of CI-Moscow) failed to maintain various records, as required by the rule. 17 C.F.R. 240.15a-6(a)(2)(iii) (referring to conditions in (3)(iii)); *id*. at 240.15a-6(a)(3)(iii)(A)(4), (D). Rapoport blames CI-New York for the faulty record-

keeping (Br. 20 n.10), but regardless of who bears responsibility, CI-New York's failures rule out an exemption under Rule 15a-6.

B. Evidentiary problems would prejudice the Division.

Rapoport cannot show that his conduct did not prejudice the Division. *Whelan v. Abell*, 48 F.3d 1247, 1259–60 (D.C. Cir. 1995). Mere delay is not the issue; rather, the concern is the "'loss of evidence'" caused by the delay. Br. 20; *Stephenson v. El-Batrawi*, 524 F.3d 907, 915 (8th Cir. 2008). The years that have passed since the conduct at issue increase the chance that documents will have disappeared, electronic data will have been erased, and memories will have faded. Rapoport's residence in Russia and his refusal to participate in the proceeding thus far—including his refusal to provide an accounting for disgorgement—further suggest that the Division's prosecution would be hampered by evidentiary problems.

III. The Commission properly exercised its discretion when it upheld the sanctions imposed by the ALJ, including the sanctions corresponding to conduct in 2003–2005 and the second-tier penalties.

Rapoport asserts that the Commission erred by declining to set aside the sanctions because (1) the Commission did not explain its reasoning (Br. 23–25); (2) the OIP did not support the imposition of sanctions for conduct in 2003–2005 (Br. 27–29); (3) the OIP did not allege scienter, which is required for second-tier

penalties (Br. 29–32); and (4) those second-tier penalties were "excessive" (Br. 32–33). These arguments all lack merit, and under this Court's highly deferential review, Rapoport has not shown that the Commission abused its discretion. *Seghers*, 548 F.3d at 135.

A. The Commission adequately addressed, and rejected, Rapoport's challenges to the sanctions.

Rapoport takes issue with the length of the Commission's analysis, labeling it "perfunctory" and "non-existent," but the Commission provided a clear explanation of why it found that the sanctions were appropriate. Br. 24–25. In his Rule 155(b) motion to the Commission, Rapoport contended, in five short paragraphs, that the sanctions should be set aside "to prevent injustice." JA 732–33. The injustice, he wrote, was that second-tier penalties were unwarranted and there was no factual basis for finding that he violated Section 15(a) in 2003, 2004, and 2005—the same arguments that he asserts here. *Id*.

The Commission disagreed, explaining that "[t]he OIP charged Rapoport with violating Section 15(a) 'from about 2003 through November 2007,'" and "alleged facts sufficient to support the imposition of second-tier penalties." JA 1172. A footnote quoted the parts of the OIP that described Rapoport's conduct in those years and that alleged scienter. JA 1172 n.32, citing JA 1163–64 n.7. Based

on these allegations, the Commission found that "[i]t was not unjust for the law judge to issue the Default Order, which did not go beyond the allegations in the OIP." JA 1173.

The Commission thus explained its reasons, describing how the allegations in the OIP supported the ALJ's findings and responding directly to Rapoport's arguments. Rapoport again confuses the federal rules with Commission practice when he discusses the Commission's obligation "to 'make an independent determination' of damages" and cites cases applying Rule 55(c). Br. 24 n.15. The federal rules do not impose any obligation on the Commission, *supra* pp. 19–20, and in any event the Commission did independently determine that the sanctions were just when it denied Rapoport's motion.

B. The OIP supported the imposition of sanctions for conduct that occurred in 2003–2005 because the OIP alleged that Rapoport violated Section 15(a) during that time.

As to the substance of the Commission's analysis, Rapoport inaccurately contends that the OIP lacked allegations concerning the years 2003–2005. Br. 27–28. As the Commission found, JA 1171, however, the OIP covered those years, charging that:

> "1. *From about 2003 through November 2007*, CI-Moscow and its executive director Rapoport—directly and through CI-New York, Yenin, CI-New York's managing director, FINOP and CFO, Chekholko, its head of sales, and Herlyn, its chief compliance office—solicited institutional investors in the United States to purchase and sell thinly-trade stocks of Russian companies, without registering as a broker-dealer as required by Section 15(a) of the Exchange Act.
>
> * * *
>
> 8. *From about 2003 until at least November 2007*, CI-Moscow and its head of brokerage operations, Rapoport, directly and indirectly solicited investors in the United States to purchase and sell thinly-traded stocks of Russian companies—so-called "second-tier," or microcap, Russian companies—without registering as broker-dealers, as required by Section 15(a) of the Exchange Act, or meeting the requirements for an exemption."

JA 26, 33 (¶¶ 1, 8) (emphases added). The OIP thus contained allegations, which were accepted as true pursuant to Rule 155(a), that Rapoport solicited U.S. investors in violation of Section 15(a) from 2003–2005.

Rapoport argues that the five-year statute of limitations (28 U.S.C. 2462) precludes penalties for conduct occurring before December 8, 2003 (the OIP was issued on December 8, 2008), but the Commission did not err when it upheld a second-tier penalty imposed for conduct occurring in the last three weeks of 2003. Br. 28. Second-tier penalties are assessed "for each such act or omission," not for each year. Section 21B(b)(2) of the Exchange Act, 15 U.S.C. 78u-2(b)(2). Rapoport does not cite any authority that forbids the ALJ from imposing a penalty

because the misconduct occurred in December, as opposed to January or July, or that requires the ALJ to prorate the penalty because the illegal conduct occurred in a single month.[11]

Even if Rapoport were correct that the OIP did not justify imposing sanctions for conduct that occurred in 2003–2005, he does not deny that the OIP supported the sanctions imposed for conduct that occurred in 2006 and 2007 (except to the extent he challenges the second-tier penalties, as discussed directly below). Rapoport's conduct in these later years supports the ALJ's finding that the public interest is served by a cease-and-desist order, an associational bar, and an order to provide an accounting for determining disgorgement, which Rapoport still has not obeyed, even after filing his Rule 155(b) motion. JA 462–65.

C. The OIP supported the imposition of second-tier penalties because it charged Rapoport with deliberately or recklessly disregarding Section 15(a).

Rapoport argues that the OIP did not "justify a finding that Rapoport acted with scienter," Br. 29, but the OIP alleged that Rapoport deliberately or recklessly disregarded Section 15(a). Section 21B of the Exchange Act, 15 U.S.C. 78u-

[11] The Division has never "acknowledged its complete lack of evidence," as Rapoport claims, and the federal complaint against Rapoport's co-respondent Chekholko hardly acknowledges a supposed lack of evidence against Rapoport. Br. 28.

2(a)(2). The OIP charged that "Rapoport *knew* that any representative of CI-Moscow who solicited a U.S. investor would have to be licensed and registered with the Commission or an appropriate U.S. self-regulatory organization." JA 28 (¶ 14) (emphasis added). Nevertheless, while he "was responsible for the brokerage operations at both CI-Moscow and CI-New York," Rapoport and other CI-Moscow employees "who were not licensed to sell securities under U.S. law or registered as brokers or dealers under U.S. law and were not exempt from such licensing and registration requirements, solicited U.S. investors directly." JA 27–28 (¶¶ 6, 11). Moreover, "[u]nder Rapoport's direction, CI-New York employees solicited U.S. investors," who were then "referred to CI-Moscow to complete the transaction." JA 28 (¶ 10).

These allegations support the ALJ's finding of scienter, and the Commission did not abuse its discretion by declining to set aside the second-tier penalties that the ALJ imposed. Rapoport inaccurately suggests that the ALJ did not differentiate between him and the other respondents, but the ALJ discussed Rapoport's specific misconduct and the specific charges against him. *Compare* Br. 9, 25, 30 n.21 *with* JA 457–58, 460–61. While the ALJ grouped all the respondents together when it concluded that their actions "demonstrated deliberate

or reckless disregard of regulatory requirements," JA 467, it had already described the specific conduct that merited the second-tier penalties against Rapoport.

The purported "complexity" of Rule 15a-6 does not make Rapoport's disregard of Section 15(a) any less deliberate or reckless. Br. 30–31. Rapoport is not eligible for an exemption because, among other reasons, he did not consent to service, CI-New York did not maintain proper records, and CI-Moscow performed tasks that CI-New York had to perform for the exemption to apply (such as issuing confirmations). *See supra* pp. 31–32.[12] Rapoport blames CI-New York for these problems (Br. 26), but regardless of who shoulders the blame, the conditions necessary for an exemption were not present. Moreover, Rapoport exercised managerial control over both CI-New York and CI-Moscow, and, at the very least, he knew that he had not consented to service, as required by the Rule. *See supra* p. 33. While he cites "legal opinions" purportedly describing the relationship between CI-New York and CI-Moscow as "in accordance with U.S. law" (Br. 31 n.23), Rapoport has neither produced those "opinions" nor asserted all the elements

[12] Rapoport notes that Rule 15a-6 permits foreign broker-dealers "to perform the actual physical execution of transactions in foreign securities" listed on foreign exchanges *if* required by those exchanges. *Rule 15a-6 Release*, 54 Fed. Reg. at 30029 n.185, cited by Br. 31 n.24. But he does not show that CI-Moscow was bound by any such requirement, and regardless, CI-Moscow performed other functions, such as issuing confirmations, that CI-New York had to perform for the exemption to apply. *Id*. at 30029 nn.186–89.

of an advice-of-counsel defense, such as demonstrating complete disclosure to counsel. *SEC v. Savoy Indus., Inc.*, 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981).

D. The sanctions imposed were not "excessive."

As a fallback, Rapoport claims that the second-tier penalties were excessive for several reasons, none of which are persuasive. Br. 32–33. He asserts that he has not previously violated the securities laws, but that does not minimize the seriousness of these violations. *E.g.*, *In re R.B. Webster Investments, Inc.*, 51 S.E.C. 1269, 1278 (1994). He claims that his misconduct did not harm investors, but loss to investors is a relevant factor for third-tier penalties, not second-tier penalties. *Compare* 15 U.S.C. 78u-2(a)(2) *with* 15 U.S.C. 78u-2(a)(3).

Rapoport further contends that the money penalties were excessive because the Division purportedly conceded that Rapoport's conduct *would* be exempt *if* CI-New York had maintained proper records and *if* Rapoport had consented to service. Br. 26, 32. There has been no such concession, but regardless, New York *did not* maintain proper records and Rapoport *did not* consent to service. The Division made no such concession because other necessary conditions for an exemption were not established, including the requirement that CI-New York issue confirmations and safeguard funds. 17 C.F.R. 240.15a-6(a)(3)(iii)(A)(2), (6).

Rapoport downplays his violation of Section 15(a), but what he views as "an arcane registration requirement" (Br. 2), this Court views as the "'keystone of the entire system of broker-dealer regulation.'" *Roth*, 22 F.3d at 1109. Rule 15a-6 created limited and "conditional" exemptions from Section 15(a) to "facilitate access to foreign markets by U.S. institutional investors," but it in no way diminished "the fundamental significance of broker-dealer registration." *Rule 15a-6 Release*, 54 Fed. Reg. at 30014.

Rapoport mentions repeatedly that the Commission *proposed* amendments to Rule 15a-6 in 2008, with the implication being that Rapoport's conduct would have been exempt under an amended rule. But, the Commission never *adopted* these amendments. Moreover, Rapoport overstates the breadth of the proposed changes because the Commission neither "criticized" nor "proposed eliminating" the registration requirement imposed by Congress. Br. 2, 7, 32. Rather, the proposed amendments were limited, and because they would have retained the record-keeping and consent-to-service requirements, among others, Rapoport would not have been eligible for an exemption even if the Commission had adopted the amendments as proposed. *Exemption of Certain Foreign Brokers or Dealers*, 73 Fed. Reg. at 39210–11. In the end, Rule 15a-6, as adopted in 1989, remains in effect, and Rapoport has not demonstrated that it applies here.

CONCLUSION

For the foregoing reasons, the order of the Commission should be affirmed.

Respectfully submitted,

MARK D. CAHN
General Counsel

MICHAEL A. CONLEY
Deputy General Counsel

JACOB H. STILLMAN
Solicitor

JOHN AVERY
Deputy Solicitor

/s/ Jeffrey A. Berger

JEFFREY A. BERGER
Senior Counsel
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-8010
(202) 551-5112 (Berger)

December 16, 2011

CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 9,574 words, excluding the parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and Circuit Rule 32(a)(1).

I also certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Word Perfect in 14-Point Times New Roman.

/s/ Jeffrey A. Berger

Jeffrey A. Berger

December 16, 2011

CERTIFICATE OF SERVICE

Pursuant to Fed. R. App. P. 31(b) and Circuit Rule 31(b), I hereby certify that on December 16, 2011, I electronically filed the original of the Commission's Final Brief, which was served on all parties via the Court's CM/ECF system, and sent eight paper copies of this brief to the Clerk of the Court via UPS. Additionally, I sent two courtesy copies of the brief to the following counsel of record via UPS:

Michael Hanin
Kasowitz, Benson, Torres & Friedman LLP
1633 Broadway
New York, New York 10019
Tel. (212) 506-1788
Fax (212) 835-5088
MHanin@kasowitz.com

/s/ Jeffrey A. Berger

Jeffrey A. Berger

REGULATORY ADDENDUM

Regulatory Addendum

Commission Rule of Practice 141, 17 C.F.R. 201.141

"(a) *Service of an order instituting proceedings* —

(1) *By whom made.* The Secretary, or another duly authorized officer of the Commission, shall serve a copy of an order instituting proceedings on each person named in the order as a party. The Secretary may direct an interested division to assist in making service.

(2) *How made* —

(i) *To individuals.* Notice of a proceeding shall be made to an individual by delivering a copy of the order instituting proceedings to the individual or to an agent authorized by appointment or by law to receive such notice. *Delivery* means—handing a copy of the order to the individual; or leaving a copy at the individual's office with a clerk or other person in charge thereof; or leaving a copy at the individual's dwelling house or usual place of abode with some person of suitable age and discretion then residing therein; or sending a copy of the order addressed to the individual by U.S. Postal Service certified, registered or Express Mail and obtaining a confirmation of receipt; or giving confirmed telegraphic notice.

(ii) *To corporations or entities.* Notice of a proceeding shall be made to a person other than a natural person by delivering a copy of the order instituting proceedings to an officer, managing or general agent, or any other agent authorized by appointment or law to receive such notice, by any method specified in paragraph (a)(2)(i) of this section, or, in the case of an issuer of a class of securities registered with the Commission, by sending a copy of the order addressed to the most recent address shown on the entity's most recent filing with the Commission by U.S. Postal Service certified, registered, or Express Mail and obtaining a confirmation of attempted delivery.

(iii) *Upon persons registered with the Commission.* In addition to any other method of service specified in paragraph (a)(2) of this section, notice may be made to a person currently registered with the Commission as a broker, dealer, municipal securities dealer, government securities broker, government securities dealer, investment

adviser, investment company or transfer agent by sending a copy of the order addressed to the most recent business address shown on the person's registration form by U.S. Postal Service certified, registered or Express Mail and obtaining a confirmation of attempted delivery.

(iv) *Upon persons in a foreign country.* Notice of a proceeding to a person in a foreign country may be made by any method specified in paragraph (a)(2) of this section, or by any other method reasonably calculated to give notice, provided that the method of service used is not prohibited by the law of the foreign country."

Commission Rule of Practice 155, 17 C.F.R. 201.155

"(a) A party to a proceeding may be deemed to be in default and the Commission or the hearing officer may determine the proceeding against that party upon consideration of the record, including the order instituting proceedings, the allegations of which may be deemed to be true, if that party fails:

(1) To appear, in person or through a representative, at a hearing or conference of which that party has been notified;

(2) To answer, to respond to a dispositive motion within the time provided, or otherwise to defend the proceeding; or

(3) To cure a deficient filing within the time specified by the commission or the hearing officer pursuant to §201.180(b).

(b) A motion to set aside a default shall be made within a reasonable time, state the reasons for the failure to appear or defend, and specify the nature of the proposed defense in the proceeding. In order to prevent injustice and on such conditions as may be appropriate, the hearing officer, at any time prior to the filing of the initial decision, or the Commission, at any time, may for good cause shown set aside a default."