INITIAL DECISION RELEASE NO. 458
ADMINISTRATIVE PROCEEDING
FILE NO. 3-14355

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

In the Matter of	:	
	:	
DONALD L. KOCH and	:	INITIAL DECISION
KOCH ASSET MANAGEMENT LLC	:	May 24, 2012

APPEARANCES: Suzanne J. Romajas and Adam Aderton for the Division of Enforcement, Securities and Exchange Commission

Thomas O. Gorman and Cecilie Howard of Dorsey & Whitney LLP for Respondents Donald L. Koch and Koch Asset Management LLC

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision (ID) concludes that Donald L. Koch (Koch) and Koch Asset Management LLC (KAM) violated the antifraud provisions of the federal securities laws by "marking the close" in the purchase of securities for advisory clients. The ID orders Respondents to cease and desist from violations of the antifraud provisions, to disgorge ill-gotten gains of $4,169.78, and to pay a civil money penalty of $75,000; imposes an investment adviser bar on Koch; and censures KAM.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission (Commission) instituted this proceeding with an Order Instituting Proceedings (OIP) on April 25, 2011, pursuant to Section 21C of the Securities Exchange Act of 1934 (Exchange Act), Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 (Advisers Act), and Section 9(b) of the Investment Company Act of 1940 (Investment Company Act). The undersigned held a six-day hearing between January 10 and January 20, 2012. Hearing sessions were held in St. Louis, Missouri (January

10-13, 2012), and Washington, DC (January 17 and 20, 2012). Ten witnesses testified, including Koch, and numerous exhibits were admitted into evidence.[1]

The findings and conclusions in this ID are based on the record. Preponderance of the evidence was applied as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). Pursuant to the Administrative Procedure Act, 5 U.S.C. § 557(c), the following post-hearing pleadings were considered: (1) the Division of Enforcement's (Division) February 13, 2012, Proposed Findings of Fact and Post-Hearing Brief; (2) Respondents' February 29, 2012, Proposed Findings of Fact and Conclusions of Law; and (3) the Division's March 8, 2012, Post-Hearing Reply Brief. All arguments and proposed findings and conclusions that are inconsistent with this ID were considered and rejected.

B. Allegations and Arguments of the Parties

This proceeding concerns Respondents' trading on behalf of advisory clients during September through December 2009. The OIP alleges that they engaged in "marking-the-close" transactions so as to artificially increase the reported closing price of one or more securities at month-end on September 30, October 30, November 30, and December 31, 2009, and thus violated the antifraud and other provisions of the securities laws.

The Division is seeking a cease-and-desist order; disgorgement; a third-tier civil money penalty; and bars (of Koch) and a censure (of KAM). Respondents argue that the charges are unproven and no sanctions should be imposed.

II. FINDINGS OF FACT

As discussed below, during September through December 2009, Respondents engaged in marking-the-close transactions in the accounts of advisory clients so as to artificially increase the reported closing price of one or more securities at quarter-end on September 30 and December 31, 2009. The closing prices affected the valuation of all Respondents' advisory clients' accounts that held the securities at the end of those quarters.

A. Respondents and Other Relevant Entities

1. Respondents

Koch has extensive experience in banking, including employment with a regional bank that bought many smaller banks, as an economist with the Federal Reserve, as a professor of finance and banking at Georgia Institute of Technology, and with the Resolution Trust Corporation, dealing with liquidations resulting from the savings and loan crisis of the 1980s; he also had a consulting business that helped banks with compliance issues with state and federal banking regulators. Tr.

[1] Citations to the transcript will be noted as "Tr. __." Citations to exhibits offered by the Division of Enforcement and by Respondents will be noted as "Div. Ex. __" and "Resp. Ex. __," respectively.

766-84. In the late 1980s, Koch began investing for himself in small community banks, drawing on his experience to value them. Tr. 784-86, 826-36. He summarized the factors that he used as "tangible book value" (TBV), which was the basis for the amount he was willing to pay for the shares of such a bank. Tr. 770-75, 785-86. He judged that TBV was the amount for which the bank could be liquidated if it failed. Tr. 821, 827, 841-42. There has been ongoing consolidation in banking. Tr. 775, 827-29. In Koch's experience, bigger banks that buy smaller banks pay at least twice TBV. Tr. 773-74, 865-66, 890. Thus, his strategy was to buy below TBV and wait. Tr. 821, 829, 860, 868. In the meantime, some of the banks, including two of those at issue, paid dividends. Tr. 828, 843, 891, 896.

Koch invested for himself for three years, and eventually yielded to the importunities of friends and associates to invest their money, founding KAM in 1992. Tr. 786-90. KAM invested only in small banks. Tr. 798. Koch did not take as a client anyone whom he had not known for a long time. Tr. 793, 809-10. KAM did not advertise or have a website. Tr. 672-73, 810-11. Koch is personally debt-averse and did not take as a client anyone with debt. Tr. 693, 788, 798. Koch met several times with each prospective client to ensure that the client agreed with his approach to investing. Tr. 798-99. The client must approach investing with him as a long-term investment with a ten-year horizon. Tr. 796-97. Koch was emphatic that the client not view the investment as a checking account to be drawn on at any time. Tr. 796. Although Koch invested only in bank stocks, he tailored each account to the client's circumstances and did not have the same mix of securities and cash for each client. Tr. 855-58.

Koch was essentially KAM's only employee. Tr. 822. Koch spends considerable time and money on his charity, the Koch Foundation, which seeks, through conferences, speakers, courses, and scholarships, to promote among young people civic values derived from the Bill of Rights, the Declaration of Independence, and the Constitution. Tr. 761-65. He is also a member of the Board of Directors of Stanford University's Hoover Institution. Tr. 765.

KAM's fees, per quarter, were 0.25% of the account's value, which was not charged if the account declined in value,[2] and, per year, 20% of realized net gains that exceeded 5% per year during the years that the assets were held. Tr. 689-92, 800, 816-17, 1012-14; Resp. Exs. 3, 5, 6, Resp. Ex. 36 at 59-68. KAM had about forty fee-paying advisory accounts held by members of about thirty families. Tr. 677, 809; Div. Ex. 306. Accounts for Koch and his family and his assistant, Faith Heidtbrink (Heidtbrink) are not charged fees. Tr. 678-83. Koch only placed limit orders, and when he placed an order for a large block of stock that was purchased in smaller lots, every account to which it was allocated paid the average price. Tr. 819-21, 859-60; Div. Ex. 279 at SEC-KOCH0007157. KAM's Policies and Procedures Manual designated Koch as the firm's Chief Compliance Officer; "Prohibited Transactions" included "any transactions intended to raise, lower, or maintain the price of any Security." Div. Ex. 279 at SEC-KOCH0007143, 0007148. KAM's Business Continuity Plan represented that KAM backs up its electronic records and stores the back-up either on-site in a fire safe vault or off-site. Div. Ex. 279 at SEC-KOCH0007170.

[2] The total of fees waived from 1996 to 2010 was over $234,000. Tr. 690-92; Div. Ex. 242.

Heidtbrink spends 25% of her time on Koch Foundation matters and another 25% on KAM. Tr. 663-67. For KAM, Heidtbrink keeps paper client files from the inception of an account including brokerage statements, confirms, correspondence, IRA withdrawals, any trust documents, and account opening documents. Tr. 684-85. She also keeps electronic records of trading using a product called Market Manager Plus (MMP), as a parallel system to the broker's records of trading. Tr. 694. KAM receives duplicate account statements and confirms of the client's statements and confirms. Tr. 695. Heidtbrink reconciles the account statements to KAM's parallel system of records every month. Tr. 695. As to confirms, KAM keeps the paper copy and also records it in MMP and in a paper logbook. Tr. 695-96; Resp. Ex. 20. KAM runs a second MMP that captures new information while she is working in the other MMP. Tr. 701-02. After trades are executed, Koch informs her as to which accounts the shares should be allocated. Tr. 707.

Because of the instant proceeding, Koch suggested that clients find other investment advisers, and KAM no longer has any fee-paying accounts. Tr. 810, 923. The clients moved within six to nine months after the OIP. Tr. 922. KAM currently only manages Koch's family assets. Tr. 923. KAM was, but no longer has sufficient assets under management to be, a Commission-registered investment adviser. Tr. 760, 787.

2. Banks

The transactions at issue were in the stock of three banks – High Country Bancorp, Inc. (HCBC), Cheviot Financial Institution (CHEV), and Carver Bancorp., Inc. (CARV). Tr. 836-55. Their stocks were illiquid.[3] Tr. 857-59. Koch calculated HCBC's TBV during the time at issue as $25 per share, meaning that he would pay up to $25 a share, which he could theoretically double over the long term. Tr. 841-43, 865-66. HCBC also paid a dividend of 5%. Tr. 843, 891. Koch had been buying HCBC for clients since the late 1990s. Tr. 837, 843-44. CHEV's TBV was between $12 and $15 per share. Tr. 849. CHEV also paid a dividend. Tr. 896. Koch had been investing in CHEV for about ten years. Tr. 846-47. CARV's TBV was above $20 per share. Tr. 851. Koch started investing in CARV in the 1990s. Tr. 851. Subsequent to the events at issue, in 2010, Koch sold out after becoming disenchanted with CARV, due to too many non-performing loans. Tr. 850, 853. The bank stocks, like the stock market generally, performed poorly in the first half of 2009. Tr. 73-74.

3. Huntleigh Securities Corporation

Huntleigh Securities Corporation (Huntleigh) is a Commission-registered broker-dealer in the St. Louis, Missouri, area. Tr. 38. Huntleigh executed transactions for KAM during the time at

[3] HCBC was KAM's most illiquid investment in 2009, with a very wide bid-ask spread of 32.6%. Tr. 1056-57, 1060-62, 1079; Resp. Ex. 39 at 21, 24. CARV and CHEV were also among KAM's fifteen most illiquid investments. Tr. 1080; Resp. Ex. 39 at 24. Of the 252 trading days in 2009, HCBC did not trade on 212, CARV did not trade on 69, and CHEV did not trade on 26. Tr. 1081-83; Resp. Ex. 39 at 25. HCBC and CARV were among the ten most widely held stocks on December 31, 2009, in a random sample of fifteen of KAM's customer accounts. Resp. Ex. 36 at 50-51.

issue.[4] Tr. 41-43. On the monthly account statements Huntleigh sent to KAM customers, the market value of equities was based on the closing price of the last trade in the market on the last day of the month, and if there were no trades in an equity, it would be valued at the bid.[5] Tr. 139-40, 215-16. Huntleigh had a fully-disclosed arrangement as introducing broker with First Clearing, LLC, as the clearing firm.[6] Tr. 46. Koch's method of ordering trades was to telephone the trading desk, not to confer with the registered representative assigned to his account, or to place orders with Huntleigh electronically. Tr. 50-52, 457-58. This was a common practice at Huntleigh. Tr. 52-53, 444-51. Huntleigh trader Jeff Christanell (Christanell) began handling KAM's trades in September 2009.[7] Tr. 53.

B. Koch's Trading in Late 2009

1. Concerned with clients' short-term focus during 2009, Koch asks Huntleigh how stocks are valued and trades HCBC accordingly on September 30

Koch wanted his clients to obtain information only from him and disagreed with Huntleigh's choice to allow clients on-line access to their account information. Tr. 48, 53-72. Koch told Huntleigh's compliance director Catherine Marshall (Marshall) that some clients were following their accounts too closely in the first half of 2009 as the market declined. Div. Ex. 121. In late August 2009, Koch asked repeatedly and insistently for the names of clients who were

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[4] KAM ceased to be a client of Huntleigh in the spring or summer of 2010 after Huntleigh asked it to remove its accounts. Tr. 44, 125-28.

[5] The reason is that an investor who had to liquidate a security would receive the bid price. Tr. 217.

[6] Until 2008, Huntleigh had been self-clearing. Tr. 46. (Although Koch had occasionally expressed concern about Huntleigh's net capital position, the change to the much bigger, well-capitalized firm was not to Koch's liking. Tr. 46-47, 171-72. On being asked to move, he asked Huntleigh for a list of self-clearing brokers in the area. Tr. 127-28; Div. Ex. 234.)

[7] Christanell entered a settlement with the Commission arising out of the events at issue. Huntleigh Securities Corp., Exchange Act Release No. 64336 (Apr. 25, 2011), 100 SEC Docket 40392. Huntleigh fired him, effective February 8, 2010, based on its conclusion that he had violated the firm's policies through what it considered to be marking-the-close transactions in HCBC at Koch's direction; Huntleigh's investigation was triggered by a regulatory inquiry from NYSE Arca Equities, Inc. Tr. 38-39, 79-91, 526-27; Div. Exs. 2, 3, 4, 33, 298, 299. Huntleigh also sought information from Koch concerning HCBC trades. Tr. 116-25; Div. Ex. 33. Koch complained to Christanell about this, offering words of support, speculating that Huntleigh was targeting Christanell to divert attention from some other questionable aspect of its business, suggesting a future partnership in which Koch would supply trading capital, and advising that they coordinate their stories. Tr. 527-28, 531-34; Div. Exs. 26, 27, 28, 221.

viewing their accounts online, saying that he wanted to know who would be calling him.[8] Div. Exs. 96, 98, 100, 101, 102, 103, 109, 112, 113, 117, 121.

Usually Koch tried to buy stocks for the cheapest possible price, as close to the bid as possible. Tr. 517, 620; Div. Exs. 205, 207, 210, 214. However, at the end of September 2009, Koch asked Christanell to achieve a closing price for HCBC, which had a wide bid-ask spread, above the ask. Tr. 465-66. On September 30, Christanell reported that the market for HCBC was $11.71 - $20 and that he had bought 580 shares at $16.6897; and he asked Koch to "Let me know what to do from here." Div. Exs. 144, 146, 148, 149, 150. Koch asked Christanell how stocks were priced at the end of the day or month.[9] Tr. 460-61; Div. Exs. 145, 146. Christanell told him that a stock is priced on the last trade if it traded that day, otherwise, at the bid, adding "In the case of HCBC today, it will get priced on the last trade." Div. Ex. 146, 148, 149, 150. Koch replied, "good. Move last trade right before 3pm up to as near to $25 as possible without appearing manipulative."[10] Div. Exs. 148, 149, 150. Acting on that instruction, Christanell revised his limit order upward to $25; his final purchase of the day was 400 shares at $23.50, which established the closing price. Resp. Ex. 39 at 43. Christanell bought a total of 2,000 shares of HCBC that day at an average price of $20.3794.[11] Div. Exs. 150, 151. KAM's trading was 100% of the trading volume of HCBC on September 30, 2009. Resp. Ex. 39 at 43.

Koch's explanation for his instruction "Move last trade right before 3pm up to as near to $25 as possible without appearing manipulative" is that he was warning Christanell not to bid for a large block of stock because that would drive the asking price up. Tr. 879-80. This interpretation departs so far from the plain meaning of the words he used as to be unconvincing. Koch further explained his limit of $25 after being informed that the ask was $20: any bid for such an illiquid stock could drive the ask up, so $25 was his limit because that was his TBV.[12] Tr. 880-81. Another of Koch's explanations for the instruction to trade "right before 3pm" (at the end of the trading day at the end of the quarter) is that is when those with stock to sell are likely to offer it into the market. Tr. 880-

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[8] The Division theorizes that Koch engaged in the conduct at issue because, having carefully explained his long-term approach to investing to each person who became a client, he was annoyed at receiving calls from clients who were focusing on the short-term performance of their accounts.

[9] Koch's explanation, which is not altogether convincing, for asking how Huntleigh priced illiquid securities was that he was taking a survey after finding that the Bank of Montreal had priced a security at the ask and that every custodian had a different method. Tr. 869-70.

[10] The market closes at 4:00 p.m. ET, which is 3:00 p.m. CT in St. Louis. Tr. 474-75, 480.

[11] Koch allocated all 2,000 shares to the account of a long-time client, ninety-two year old Alice Smith. Tr. 137-38; Div. Exs. 8, 286; Resp. Ex. 5. He said he did this because she liked the company, it paid a dividend, and she had a significant cash position at the time. Tr. 673-75, 872-73, 802, 891. Alice Smith died in July 2010. Tr. 673, 675, 802.

[12] Koch noted that even if he paid $25 for the last purchase of the day, his average price would be lower. Tr. 882.

81. However, as Koch concedes, he did not buy HCBC (or CHEV or CARV) on the last day of any month in 2009 except those at issue. Tr. 909-10. In Koch's view, he got a "terrific deal" – $5 below TBV – on 2,000 shares in a long-term investment that he knew well.[13] Tr. 883.

2. October 30, 2009 – HCBC

On October 30, 2009,[14] Christanell purchased a total of 600 shares of HCBC,[15] based on a market order, routed to the street in the last fifteen minutes of the trading day. Resp. Ex. 39 at 48. At that time the bid-ask quote was $13.25 - $14.00. Resp. Ex. 39 at 48. Christanell filled the order with 200 shares at $14.00, followed by another buyer's purchase of 800 shares at $14.00, followed by KAM's purchase of 200 shares at $18.00 and a second 200 share purchase at $19.75, which set the closing price. Resp. Ex. 39 at 48. Christanell vaguely recalls that Koch instructed him to get the stock price up somewhere in the range of $20 to $25. Tr. 493-94. However, the record does not contain any additional evidence of communications between the two men.

3. November 30, 2009 – HCBC

On November 30, 2009, KAM placed a 2,000 share limit order at $21.00 when the bid-ask quote was $14.00 - $17.00. Christanell filled it in the last three minutes of the trading day as follows: 200 shares at $17.00, 800 shares at $17.00, and 1,000 shares at $17.49, which established the closing price.[16] Resp. Ex. 39 at 53. KAM's trading was 100% of the trading volume on November 30, 2009. Resp. Ex. 39 at 53. The only contemporaneous communication about the trades was an email from Christanell to Koch: "HCBC – Bot 2000 @ 17.245 – Sorry, just looked like someone had them for sale." Div. Ex. 15. Koch testified that this meant that Christanell had bought the stock without an order from KAM and was seeking Koch's ratification, which he supplied.[17] Tr. 889. However, a month later on December 31, 2009, Christanell told Koch, in response to a suggestion that he might start trading in the last half hour, "I might start in the last hour or so because the last time I think I waited too long." Div. Ex. 189.

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[13] Koch has every share of HCBC he has ever bought. Tr. 884.

[14] Official notice, pursuant to 17 C.F.R. § 201.323, is taken of the fact that October 31, 2009, was a Saturday, so that Friday, October 30, was the last trading day of the month.

[15] The shares were allocated to Alice Smith's account. Tr. 137-38; Div. Ex. 13.

[16] All 2,000 shares were allocated to an Alice Smith account, specifically, the account of the Philip H. Smith Family Trust, of which Alice Smith and Koch were trustees. Tr. 137-38; Div. Ex. 14.

[17] Koch allowed Christanell to buy stock, within Koch's limits, and obtain Koch's approval afterward. Tr. 888-89, 903. However, somewhat inconsistently, Koch also claims Christanell did not really understand him or how to buy blocks of stock in small companies. Tr. 903.

4. Year End 2009[18] – HCBC, CHEV, and CARV

On December 23, 2009, Koch emailed Christanell, "I also will want to move up HCBC the last day of the year before things close down…..so, please be mindful of that if you are there or your backup is around….should be a busy day." Resp. Ex. 33 at SEC-HUNTLEIGH0004660. On December 28, Koch emailed Christanell: "Please put on your calendar to buy HCBC 30 minutes to an hour before the close of market for the year. I would like to get a closing price in the 20-25 range, but certainly above 20." Div. Ex. 186.

On December 31, 2009, Koch telephoned Christanell several times and discussed purchases of HCBC, CHEV, and CARV.[19] At 7:46 a.m. CST,[20] Koch said, "You're all set. You know what to do with HCBC . . . . My parameters are, if you need 5,000 shares, do whatever you have to do. I need to get it above 20 . . . 20 to 25, I'm happy . . . . You figure out if you want to do it the last half hour . . . ." Christanell replied, "I might start in the last hour or so because last time I think I waited too long." Koch responded, "get it up there . . . . You can go up to 5,000 shares if you need to . . . . talk if you need more than that." Div. Ex. 189. At 9:55 a.m. CST, Koch said, "[Faith] is looking to see what else you want to move up . . . toward the end of the year. . . .We got three – we got Cheviot, [Christanell interrupts] We'll give you some more orders of a couple of these thin stocks I want to push up a little bit." Div. Ex. 193. At 11:41 a.m. CST, Koch asked about CHEV, and Christanell told him it was at $7.20 to $7.48. Koch replied, "Let's see if by the end of the day you move it above 8, 8 and a quarter . . . . We're still on HCBC." When Koch asked about CARV, Christanell told him "CARV is 8.10 to 9.05 . . . . No trades today." Koch responded, "What you do at the end of the day, pop that one."[21] Div. Ex. 191. At 2:09 p.m. CST, Christanell reported, "I

[18] At the end of 2009, Koch believed that his small banks were particularly undervalued because they were seen in the same questionable light as the big banks. Tr. 895, 904, 906-07.

[19] Huntleigh recorded calls from its trading desk phone lines, and copies of audio recordings of these calls are in evidence as Division Exhibits 188, 189, 190, 191, 192, and 193. At the request of Marshall, who was responding to a regulatory inquiry, in February 2010, Eli Straeter, Huntleigh's IT manager, searched its recording system for files containing calls between Christanell and Koch on the four month-end days at issue. Tr. 91-95, 379-85, 402. He found calls on December 31, 2009, and copied them onto disks. Tr. 384-93, 423-27; Div. Exs. 188, 189, 190, 191, 192, 193, 319. He could find no recordings for any other day in 2009 or 2010. Tr. 382-83. He theorized that he rebooted all the equipment in his server room on December 31 and did not restart the recording equipment; he did not use any forensic tools to find out what might have been overwritten and could be retrieved. Tr. 400-01, 409-17. While there is no explanation in the record as to why there were no records of calls before December 31, there is no evidence, engineering or otherwise, to show that the individual recordings of December 31 were altered or edited.

[20] The times associated with the recordings are in Greenwich Mean Time, which is six hours ahead of CST, local time in St. Louis, on December 31, a fact of which official notice is taken, pursuant to 17 C.F.R. § 201.323.

[21] Koch testified that he did not know what he meant by this. Tr. 905-06.

haven't done anything yet . . . . Koch said, "We got three – we got Cheviot [Christanell interrupts] . . ." Christanell asked, "What kind of volume should I use on Cheviot?" Koch replied, "start at the 100, 200 share increment . . . see how far it moves . . . since it trades so little . . . [unintelligible] pretty fast." Christanell asked, "Am I all right taking 5,000 if I have to?" Koch replied, "absolutely . . . on both of them . . ." Christanell responded "HCBC also. . . . Carver . . . . I was thinking of just buying . . . 300 shares at 9.05 – is that all right?" Koch replied, "perfect." Div. Ex. 190.

The bid-ask quote for HCBC was $14.05 - $16.80, when Christanell executed the first trade of the day in that stock. Resp. Ex. 39 at 61. He bought a total of 3,200 shares in several transactions, the last of which, within two minutes of the close, was for $19.50 and set the closing price. Div. Ex. 278 at 1; Resp. Ex. 39 at 61. The previous transaction, by another buyer one minute earlier, was at $17.50. Div. Ex. 278 at 1; Resp. Ex. 39 at 61.

At about 2:40 p.m. CST, when the bid-ask quote was $7.20 - $7.48, Christanell routed limit orders for CHEV at $8.25 to the street and obtained several executions at various prices of $8.00 and below. Div. Ex. 278 at 3; Resp. Ex. 39 at 30-31. His last execution, within ten seconds of the close was at $7.99; however, a subsequent purchase at $7.39 by another buyer set the closing price. Div. Ex. 278 at 3; Resp. Ex. 39 at 30-31. KAM purchased a total of 6,000 shares of CHEV before the close. Div. Ex. 278; Resp. Ex. 39 at 30-31.

Within two minutes of the close of trading, Christanell routed an order for 200 shares of CARV to the street and obtained 100 shares at $9.045 and another 100 shares at $9.05.[22] Div. Ex. 278 at 3; Resp. Ex. 39 at 63. CARV closed at $9.05. Resp. Ex. 39. When asked why he tried to acquire such a small block of CARV, in which he was losing confidence, Koch replied with a convoluted explanation that in fact makes no sense. Tr. 904-06, 923-25.

All of the HCBC, CHEV, and CARV shares purchased on December 31, 2009, were allocated to a Tampsco account. Tr. 137-38; Div. Ex. 17. The Tampsco accounts were for a family office managed by lawyer John McFarland, one of KAM's original clients. Tr. 676-77, 806-07. According to Koch, he allocated the trades to Tampsco because it was one of his oldest clients, needed the yield, and had a high cash position of 17-18%. Tr. 907-08.

5. Koch intended to "Mark the Close" on September 30 and December 31

An explanation for KAM's trading patterns at issue was provided by Koch and two expert witnesses whom he called, John Schneider (Schneider)[23] and Greg Jarrell (Jarrell).[24] Tr. 858-906, 927, 943-1005, 1053-1140, 1154-91, 1206-70; Resp. Exs. 36, 39. HCBC, CHEV, and CARV were illiquid, thinly-traded stocks. HCBC was so thinly-traded – having traded on only 40 of the 252

[22] Resp. Ex. 39 erroneously shows both fills at $9.05. Tr. 1101-02.

[23] Schneider was accepted as an expert in investment advisory services, including compliance programs for small advisory firms. Tr. 932-940

[24] Jarrell was accepted as an expert in the economics of markets. Tr. 1043, 1050.

trading days in 2009 – that Jarrell described it as "non-liquid." As such, these stocks had extremely wide spreads between their bid and ask prices. A prospective buyer could not expect to buy at the bid; rather he would have to bid near or at the ask if he wished to obtain the stock. Such a bid might draw out stock from a prospective seller. A trader might follow a process of laddering in filling an order during the trading day, filling portions of the order at increasingly higher prices as the day went on. There is more trading and liquidity at the end of the trading day and a prospective buyer might be more likely to obtain stock by bidding at the end of the day. Likewise, there is more liquidity at the end of a quarter, month, or year, when sellers might want to lock in profits or losses or obtain cash for other reasons. As an indication of a legitimate purpose for the transactions at issue, Koch also emphasized that he did not bid over the TBV for each of the stocks. This explanation would provide a reasonable and non-violative explanation for all the trading at issue if it were not for Koch's email exchanges and telephone conversations with Christanell concerning the September 30 and December 31 trading. Those communications show that Koch's motive for the trades on those days was to affect the closing price by the last transaction of the trading day. Lacking such evidence for the October 30 and November 30 trading and in light of the Division's burden of proof, this motive is not found on those days.

6. Excess Quarterly Fees

The higher prices attained for HCBC and CARV on September 30 and December 31 resulted in higher valuations of account holdings at quarter end, which resulted in higher quarterly fees paid by paying clients. The parties agree that this excess amounts to $4,169.78.

7. Missing Emails

As described above, the record includes emails between Koch and Christanell with incriminating language. Div. Exs. 146, 148, 149, 150, 186, 187. Bates stamps (SEC-HUNTLEIGH000XXX) on these exhibits and correspondence between the Division and Huntleigh indicate that they were produced by Huntleigh in response to a request by the Division. Div. Exs. 303, 304. By contrast, Division Exhibit 151, which is the final email in the string shown on Division Exhibit 150 (which incorporates the previous emails of Division Exhibits 146, 148, and 149), merely contains the innocuous report "Bot 2000 HCBC @ 20.3794." The Bates stamp (SEC-KOCH000098) on Division Exhibit 151 indicates that it originated from Koch. The Division argues that it was produced in response to a Division administrative subpoena and that the emails containing incriminating language were not produced[25] and had presumably been deleted or destroyed in violation of requirements that KAM maintain such records. The Division's subpoena, however, is not in the record of evidence, so it is not possible to evaluate Koch and/or KAM's response.[26] Consequently, it is not possible to find that Respondents deleted or destroyed records.

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[25] A Division staffer who reviewed KAM's document production testified that KAM did not produce the emails that comprise Division Exhibits 146, 148, 149, and 150. Tr. 290-94.

[26] Koch and Heidtbrink conducted an extensive search and produced copies of a large quantity of documents in response to correspondence and a subpoena. Tr. 712-19, 824-25.

III. CONCLUSIONS OF LAW

The OIP charges that Respondents willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and 206(2) of the Advisers Act. Additionally, it charges that KAM willfully violated and Koch caused and willfully aided and abetted KAM's violation of Sections 204 and 206(4) of the Advisers Act and Rules 204-2(a)(7) and 206(4)-7 thereunder. As discussed below, it is concluded that Respondents willfully violated Exchange Act Section 10(b) and Rule 10b-5 and Advisers Act Sections 206(1), 206(2), and 206(4) and Rule 206(4)-7 and that violations of Advisers Act Section 204 and Rule 204-2(a)(7) are unproven.

A. Antifraud Provisions

Respondents are charged with willfully violating the antifraud provisions of the Exchange and Advisers Acts – Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1), 206(2), and 206(4) of the Advisers Act – which prohibit essentially the same type of conduct. United States v. Naftalin, 441 U.S. 768, 773 n.4 & 778 (1979); SEC v. Pimco Advisors Fund Mgmt. LLC, 341 F. Supp. 2d 454, 469 (S.D.N.Y. 2004).

Exchange Act Section 10(b) and Rule 10b-5 make it unlawful "in connection with the purchase or sale of" securities, by jurisdictional means, to:

1) employ any device, scheme, or artifice to defraud;

2) make any untrue statement of a material fact or any omission to state a material fact necessary to make the statement made not misleading; or

3) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Similar proscriptions are contained in Advisers Act Sections 206(1), 206(2), and 206(4).

The specific fraud charged in the instant proceeding is marking the close, a form of market manipulation. Market manipulation is intentional conduct designed to defraud investors by artificially affecting the prices of securities. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976). "An attempted manipulation is as actionable as a successful one." S.E.C. v. Martino, 255 F. Supp. 2d 268, 287 (S.D.N.Y. 2003), aff'd, 94 Fed. Appx. 871 (2d Cir. 2004); accord, Kuehnert v. Texstar Corp., 412 F.2d 700, 704 (5th Cir. 1969); Michael J. Markowski, Exchange Act Release No. 43259 (Sept. 7, 2000), 54 S.E.C. 830, 835, aff'd, 274 F.3d 525 (D.C. Cir. 2001). The Commission has stated, "Manipulation is the creation of deceptive value or market activity for a security, accomplished by an intentional interference with the free forces of supply and demand. A finding of manipulation does not hinge on the presence or absence of any particular device usually associated with a manipulative scheme." Swartwood, Hesse, Inc., Exchange Act Release 31212 (Sept. 22, 1992), 50 S.E.C. 1301, 1307 (footnotes omitted). "Proof of a manipulation almost always depends on inferences drawn from a mass of factual detail. Findings must be gleaned from patterns of behavior, from apparent irregularities, and from trading data." Pagel, Inc., Exchange Act Release No. 22280 (Aug. 1, 1985), 48 S.E.C. 223, 226, aff'd, 803 F.2d 942 (8th Cir. 1986). Manipulative transactions can appear to be legitimate market transactions if the manipulative motive is disregarded.[27] Markowski, 274 F.3d at 527-28.

Marking the close "is the practice of attempting to influence the closing price of a stock by executing purchase or sale orders at or near the close of the market." Thomas C. Kocherhans, Exchange Act Release No. 36556 (Dec. 6, 1995), 52 S.E.C. 528, 530; accord, Adrian C. Havill, Exchange Act Release No. 40726 (Nov. 30, 1998), 53 S.E.C. 1060, 1062, 1065; Sharon M. Graham, Exchange Act Release No. 40727 (Nov. 30, 1998), 53 S.E.C. 1072, 1074 at n.4. Marking the close conveys false information as to a stock's real price free of manipulative influences. Kocherhans, 52 S.E.C. at 530. A fortiori, such a trade is illegal market manipulation if it would not have occurred but for the manipulative intent. SEC v. Masri, 523 F. Supp. 2d 361, 372 (S.D.N.Y. 2007); accord, SEC v. Kwak, No. 3:04–cv–1331 (JCH), 2008 WL 410427, *4 n.10 (D. Conn. Feb. 12, 2008).

Scienter is required to establish violations of Exchange Act Section 10(b) and Rule 10b-5 and Advisers Act Section 206(1). Aaron v. SEC, 446 U.S. 680, 690-91, 695-97 (1980); SEC v. Steadman, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992). It is "a mental state embracing intent to deceive, manipulate, or defraud." Aaron, 446 U.S. at 686 n.5; Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 & n.12 (1976); SEC v. Steadman, 967 F.2d at 641. Recklessness can satisfy the scienter requirement. See David Disner, Exchange Act Release No. 38234 (Feb. 4, 1997), 52 S.E.C. 1217, 1222 & n.20; SEC v. Steadman, 967 F.2d at 641-42; Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990). Reckless conduct is "conduct which is 'highly unreasonable' and represents 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38, 47 (2d Cir. 1978) (quoting Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977)).

Scienter is not required to establish a violation of Section 206(2) or 206(4) of the Advisers Act; a showing of negligence is adequate. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); SEC v. Steadman, 967 F.2d at 643 & n.5; Steadman v. SEC, 603 F.2d 1126, 1132-34 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981).

KAM is accountable for the actions of its responsible officer, Koch. See C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1435 (10th Cir. 1988) (citing A.J. White & Co. v. SEC, 556 F.2d 619, 624 (1st Cir. 1977)). A company's scienter is imputed from that of the individuals controlling it. See SEC v. Blinder, Robinson & Co., Inc., 542 F. Supp. 468, 476 n.3 (D. Colo. 1982) (citing SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1096-97 nn.16-18 (2d Cir. 1972)). As an associated person of KAM, Koch's conduct and scienter are also attributed to the firm. See Section 203(e) of the Advisers Act.

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[27] As stated in a case involving alleged manipulation by means of short sales, there "must be some circumstances beyond the mere occurrence of short sales to suggest that the short sales were part of a scheme to manipulate the market" and "it is unreasonable to infer unlawful intent from lawful activity alone." GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 198, 207-08, 211 (3d Cir. 2001) (quoting the District Court).

Material misrepresentations and omissions violate Exchange Act Section 10(b) and Rule 10b-5 and Advisers Act Sections 206(1), 206(2), and 206(4). The standard of materiality is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not to invest. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); SEC v. Steadman, 967 F.2d at 643.

Koch, as owner, sole principal, president, and CEO of KAM, was an associated person of an investment adviser. See Advisers Act Sections 202(a)(17), 203(f). Investment advisers and their associated persons are fiduciaries and are held to a higher standard than broker-dealers and their associated persons. Fundamental Portfolio Advisors, Inc., Securities Act Release No. 8251 (July 15, 2003), 56 S.E.C. 651, 684; see Capital Gains Research Bureau, Inc., 375 U.S. at 191-92, 194, 201; see also Transamerica Mortg. Advisors, Inc. v. Lewis, 444 U.S. 11, 17 (1979).

An associated person may be charged as a primary violator, where, as here, the investment adviser is an alter ego of the associated person. John J. Kenny, Securities Act Release No. 8234 (May 14, 2003), 56 S.E.C. 448, 485 n.54. Accordingly, as discussed below, it is concluded that Koch violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder and that Respondents did not violate Advisers Act Section 204 and Rule 204-2(a)(7). Thus, it is unnecessary to address his secondary liability for violating those provisions.

In addition to requesting a cease-and-desist order pursuant to Section 21C of the Exchange Act and Section 203(j) of the Advisers Act, the Division requests sanctions pursuant to Sections 203(e), 203(f) and 203(i) of the Advisers Act and 9(b) of the Investment Company Act. Willful violations by Respondents must be found in order to impose sanctions on them pursuant to Sections 203(e), 203(f) and 203(i) of the Advisers Act and 9(b) of the Investment Company Act. A finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation. See Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000); Steadman v. SEC, 603 F.2d at 1135; Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

B. Antifraud Violations

The record shows that Respondents violated Exchange Act Section 10(b) and Rule 10b-5 and Advisers Act Sections 206(1), 206(2), and 206(4). Koch's actions show at least a reckless degree of scienter – highly unreasonable and an extreme departure from the standards of ordinary care – and a clear violation of the fiduciary duty owed by an investment adviser.

As evidenced by his emails and phone calls, Koch clearly intended and acted to affect the closing price of securities on September 30 and December 31. Informed that the market for HCBC was \$11.71 - \$20, Koch's September 30 email to Christanell to "[m]ove last trade right before 3pm up to as near to \$25 as possible without appearing manipulative" is direct evidence of Koch's intent to manipulate the closing price of HCBC. Koch's unconvincing explanation – that he was warning Christanell not to bid for a large block of stock because that would drive the asking price up – underscores that intent. In fact, he recognized that the trading was manipulative but did not want it to appear as such. KAM's trading was 100% of the trading volume on September 30, and its final purchase of the day for $23.50 set the closing price. Koch claims that his purchases that day were a "terrific deal" but does not explain why he did not urge Christanell to buy the shares as cheaply as possible rather than to buy "up to as near as $25 as possible without appearing manipulative." In short, but for his manipulative intent, Koch's September 30 HCBC purchases, including the $23.50 purchase that established the closing price, would not have been made.

Likewise, Koch's December 31 purchases of HCBC were made for the purpose of marking the close, as established by his email and telephone communications: "I would like to get a closing price in the 20-25 range, but certainly above 20," "I need to get it above 20 . . . 20 to 25, I'm happy." Further, with reference to CHEV and CARV on December 31, Koch demonstrated his manipulative intent when he said, "We'll give you some more orders of a couple of these thin stocks I want to push up a little bit." Although the last execution of his CHEV order was within ten seconds of the close, it did not succeed in setting the closing price. The purchase of a small number of shares in CARV, with which Koch was becoming disenchanted, at the ask also would not have occurred absent the intent to mark the close.

The evidence is insufficient to establish that Koch intended to manipulate the closing price on October 30 and November 30. While Christanell vaguely recalls Koch instructing him to increase HCBC's closing price on October 30, there is no additional evidence of their communications concerning trading on that day. Christanell's November 30 email to Koch is at best ambiguous and does not show that Koch had instructed Christanell to mark the close. Therefore, it is concluded that manipulative intent for these days is unproven.

Although Koch had previously invested in HCBC, CHEV, and CARV, he would not have bought them on September 30 and December 31 at the prices at which they were executed but for his purpose of manipulating their closing prices. Further, Koch's seeking to mark the close by purchases for the accounts of others at higher prices than would have resulted from legitimate market forces violated his fiduciary duty as an investment adviser.[28] Koch's manipulative intent altered the timing and prices of his trades and, therefore, Respondents violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1), 206(2), and 206(4) of the Advisers Act.

C. <u>Rule 206(4)-7(a)</u>

Advisers Act Rule 206(4)-7(a) requires a Commission-registered investment adviser that provides investment advice to "[a]dopt and implement written policies and procedures reasonably designed to prevent violation by [the adviser] of the Act and the rules that the Commission has adopted under the Act." While KAM's Policies and Procedures Manual in fact prohibited "any

[28] There is no merit to Respondents' argument that any increase in the value of assets on account statements resulting from the purchases at issue would have been immaterial for the average KAM client and that any resulting quarterly fee increase would have been immaterial in an arithmetic sense. Under the applicable legal standard of materiality, a reasonable investor would have considered information about Koch's trading tactics to be important in deciding whether or not to invest.

transactions intended to raise, lower, or maintain the price of any Security," the Division reasons that this was not implemented within the meaning of the rule because such transactions did occur. Inasmuch as KAM was a one-man firm and Koch was its alter ego as well as its Chief Compliance Officer, it is concluded that KAM and Koch did not implement the anti-manipulation policy and thus violated the rule.

D. Books and Records

Section 204 of the Advisers Act requires Commission-registered advisers to maintain various records prescribed by the Commission in rules. Advisers Act Rule 204-2(a)(7) requires registered investment advisers to keep "originals of all written communications received and copies of all written communications sent . . . relating to . . . (iii) the placing or execution of any order to purchase or sell any security." Pursuant to Rule 204-2(f), this requirement survives discontinuance of business subject to registration under Section 203 of the Advisers Act.

The Division argues that Respondents did not produce a copy of a September 30, 2009, email from Koch to Christanell in response to a Division subpoena and that this shows that the email had not been maintained, in violation of Advisers Act Section 204 and Rule 204-2(a)(7). As found above, however, the subpoena is not in evidence, so it is not possible to evaluate Respondents' response and make further inferences about records maintained by Respondents. Accordingly, the allegations concerning Advisers Act Section 204 and Rule 204-2(a)(7) are unproven.

IV. SANCTIONS

The Division requests a cease-and-desist order, disgorgement of ill-gotten gains plus prejudgment interest, a third-tier civil money penalty, and that KAM be censured and Koch barred from the securities industry. As discussed below, Respondents will be ordered to cease and desist from violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, to disgorge $4,169.78 plus prejudgment interest, and to pay a second-tier civil penalty of $65,000, KAM will be censured, and an investment adviser bar will be imposed on Koch.

A. Sanction Considerations

In determining sanctions, the Commission considers such factors as:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman, 603 F.2d at 1140 (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. Marshall E. Melton, Advisers Act Release No. 2151 (July

25, 2003), 56 S.E.C. 695, 698. Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. Schield Mgmt. Co., Exchange Act Release No. 53201 (Jan. 31, 2006), 87 SEC Docket 848, 862 & n.46. As the Commission has often emphasized, the public interest determination extends to the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. See Christopher A. Lowry, Advisers Act Release No. 2052 (Aug. 30, 2002), 55 S.E.C. 1133, 1145, aff'd, 340 F.3d 501 (8th Cir. 2003); Arthur Lipper Corp., 46 S.E.C. 78, 100 (1975). The amount of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. See Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); see also Leo Glassman, 46 S.E.C. 209, 211-12 (1975).

B. Sanctions

1. Cease and Desist

Sections 21C(a) of the Exchange Act and 203(k) of the Advisers Act authorize the Commission to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" any provision of those Acts or rules thereunder. Whether there is a reasonable likelihood of such violations in the future must be considered. KPMG Peat Marwick LLP, Exchange Act Release No. 43862 (Jan. 19, 2001), 54 S.E.C. 1135, 1185. Such a showing is "significantly less than that required for an injunction." Id. at 1183-91. In determining whether a cease-and-desist order is appropriate, the Commission considers the Steadman factors quoted above, as well as the recency of the violation, the degree of harm to investors or the marketplace, and the combination of sanctions against the respondent. See id. at 1192; see also WHX Corp. v. SEC, 362 F.3d 854, 859-61 (D.C. Cir. 2004).

Respondents' conduct was egregious and recurrent over a period of three months. The conduct involved at least a reckless degree of scienter. The lack of assurances against future violations and recognition of the wrongful nature of the conduct goes beyond a vigorous defense of the charges. Koch's chosen occupation in the financial industry will present opportunities for future violations. The violations were recent, having ended about two years ago. The degree of harm to the marketplace is quantified in the $4,169.78 of additional quarterly fees that Respondents received as a result of their misconduct. In light of these considerations, a cease-and-desist order is appropriate.

2. Disgorgement

Sections 21C(e) of the Exchange Act and 203(j) of the Advisers Act authorize disgorgement of ill-gotten gains from Respondents. Disgorgement is an equitable remedy that requires a violator to give up wrongfully obtained profits causally related to the proven wrongdoing. See SEC v. First City Fin. Corp., 890 F.2d 1215, 1230-32 (D.C. Cir. 1989); see also Hateley v. SEC, 8 F.3d 653, 655-56 (9th Cir. 1993). It returns the violator to where he would have been absent the violative activity.

The Division requests that Respondents be ordered to disgorge ill-gotten gains consisting of additional quarterly fees that Respondents received as a result of their misconduct. Accordingly, Respondents will be ordered to disgorge $4,169.78

Respondents will be held jointly and severally liable for the disgorgement because KAM was Koch's alter ego in the violative activities. See Daniel R. Lehl, Securities Act Release No. 8102 (May 17, 2002), 55 S.E.C. 843, 874-75 & n.65 (citing First Pac. Bancorp, 142 F.3d 1186, 1191 (9th Cir. 1998) (citing SEC v. Hughes Capital Corp., 124 F.3d 449, 455 (3d. Cir. 1997); SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1475 (2d. Cir. 1996); Hateley, 8 F.3d 653, 656 (9th Cir. 1993)).

3. Civil Money Penalty

Section 203(i) of the Advisers Act authorizes the Commission to impose civil money penalties for willful violations of the Exchange or Advisers Acts or rules thereunder. In considering whether a penalty is in the public interest, the Commission may consider six factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) previous violations; (5) deterrence; and (6) such other matters as justice may require. See Section 203(i)(3) of the Advisers Act; New Allied Dev. Corp., Exchange Act Release No. 37990 (Nov. 26, 1996), 52 S.E.C. 1119, 1130 n.33; First Sec. Transfer Sys., Inc., Exchange Act Release No. 36183 (Sept. 1, 1995), 52 S.E.C. 392, 395-96; see also Jay Houston Meadows, Exchange Act Release No. 37156 (May 1, 1996), 52 S.E.C. at 787-88, aff'd, 119 F.3d 1219 (5th Cir. 1997); Consol. Inv. Servs., Inc., Exchange Act Release No. 36687 (Jan. 5, 1996), 52 S.E.C. 582, 590-91.

Respondents violated the antifraud provisions, so their violative actions "involved fraud [and] reckless disregard of a regulatory requirement" within the meaning of Section 203(i)(3) of the Advisers Act. Harm to others is quantified in the approximately $4,169.78 in extra fees paid by clients. Deterrence requires penalties against Respondents because of the abuse of the fiduciary duty owed to advisory clients.

Penalties are in the public interest in this case. Penalties in addition to the other sanctions ordered are necessary for the purpose of deterrence. See Section 203(i)(3)(E) of the Advisers Act; see also H.R. Rep. No. 101-616 (1990). The Division requests that Respondents be ordered to pay third-tier penalties without specifying dollar amounts or units of violation. However, second tier penalties are appropriate. While Respondents' actions "involved fraud [and] reckless disregard of a regulatory requirement" within the meaning of Section 203(i)(2)(B) of the Advisers Act, they did not "result[] in substantial losses or create[] a significant risk of substantial losses to other persons or result[] in substantial pecuniary gain to [Respondents]" within the meaning of Section 203(i)(2)(C). For each violative act or omission after March 3, 2009, the maximum second-tier penalty is $75,000 for a natural person and $375,000 for any other person. 17 C.F.R. § 201.1004. The provisions, like most civil penalty statutes, leave the precise unit of violation undefined. See Colin S. Diver, The Assessment and Mitigation of Civil Money Penalties by Federal Administrative Agencies, 79 Colum. L. Rev. 1435, 1440-41 (1979).

The events at issue will be considered as one course of action. Since KAM was essentially a one-man operation and was Koch's alter ego in the violative activities, a second-tier penalty of $75,000 will be ordered against Respondents, jointly and severally.

4. Censure and Bar

The Division requests that KAM be censured and that Koch be barred from association with an investment adviser and subject to collateral industry bars, as well. The censure and investment adviser bar are authorized pursuant to Sections 203(e) and 203(f) of the Advisers Act and will be ordered.[29] Combined with other sanctions ordered, the censure and bar are in the public interest and appropriate deterrents. The violations involved scienter. Respondents' business provides them with the opportunity to commit violations of the securities laws in the future. The record shows a lack of recognition of the wrongful nature of the violative conduct.

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the record index issued by the Secretary of the Commission on May 4, 2012, as corrected on May 18, 2012.[30]

VI. ORDER

IT IS ORDERED that, pursuant to Sections 21C(a) of the Exchange Act and 203(k) of the Advisers Act, Koch Asset Management LLC and Donald L. Koch CEASE AND DESIST from committing or causing any violations or future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

IT IS FURTHER ORDERED that, pursuant to Section 203(j) of the Advisers Act, Koch Asset Management LLC and Donald L. Koch, jointly and severally, DISGORGE $4,169.78 plus prejudgment interest at the rate established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), compounded quarterly, pursuant to 17 C.F.R. § 201.600(b). Pursuant to 17 C.F.R. § 201.600(a), prejudgment interest is due from January 1, 2010, through the last day of the month preceding which payment is made.

IT IS FURTHER ORDERED that, pursuant to Section 203(i) of the Advisers Act, Koch Asset Management LLC and Donald L. Koch, jointly and severally, PAY A CIVIL MONEY PENALTY of $75,000.

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[29] The Division's request includes a collateral bar pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). However, Respondents' misconduct antedates the July 22, 2010, effective date of the Dodd-Frank Act. Neither the Commission nor the courts have approved such retroactive application of its provisions in any litigated case, and the undersigned declines to impose the new sanction retroactively. See Koch v. SEC, 177 F.3d 784 (9th Cir. 1999); see also Sacks v. SEC, 648 F.3d 945 (9th Cir. 2011).

[30] See Donald L. Koch, Admin. Proc. No. 3-14355 (A.L.J. May 18, 2012) (unpublished) (correcting the record index to reflect the correct filing date of ten pleadings Respondents filed).

IT IS FURTHER ORDERED that, pursuant to Section 203(e) of the Advisers Act, Koch Asset Management IS CENSURED for violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

IT IS FURTHER ORDERED that, pursuant to Section 203(f) of the Advisers Act, Donald L. Koch IS BARRED from association with any investment adviser.

IT IS FURTHER ORDERED that the allegations that KAM willfully violated, and Koch willfully aided and abetted and caused violations of, Section 204 of the Advisers Act and Rule 204-2(a)(7) ARE DISMISSED.

Payment of penalties and disgorgement plus prejudgment interest shall be made on the first day following the day this Initial Decision becomes final. Payment shall be made by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission. The payment, and a cover letter identifying Respondents and Administrative Proceeding No. 3-14355, shall be delivered to: Office of Financial Management, Accounts Receivable, 100 F Street N.E., Washington, DC 20549-6042. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111(h) of the Commission's Rules of Practice, 17 C.F.R. § 201.111(h). If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

Carol Fox Foelak
Administrative Law Judge