IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

SECURITIES AND EXCHANGE COMMISSION,	)	
	)	
Plaintiff,	)	
	)	**No. 20-cv-2104**
v.	)	
	)	**Hon. Michael A. Shipp**
JOHN D. FIERRO	)	
and	)	**Motion Day: July 6, 2020**
JDF CAPITAL, INC.,	)	
	)	
Defendants.	)	
	)	
	)	
	)	

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S OPPOSITION TO DEFENDANTS' MOTION TO DISMISS

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INTRODUCTION

The SEC's Complaint alleges in detail that (1) John D. Fierro and JDF Capital, Inc. (collectively "Defendants") have operated a regular business, the very purpose of which is to buy and sell securities for their own account, and (2) Defendants have not registered with the SEC as required by the plain language of Section 15(a)(1) of the Securities Exchange Act of 1934 ("Exchange Act"). *See* 15 U.S.C. § 78o(a)(1).

Defendants have moved to dismiss the Complaint, contending that the SEC has failed to state a claim for relief. Although they effectively admit that they meet the Exchange Act's broad definition of "dealer," because they buy and sell securities for their own account, *see* 15 U.S.C. § 78c(a)(5)(A), they seek to dismiss the Complaint on the grounds that they qualify for what is known as the "trader" exception, which exempts from the registration requirement those whose trading is not done as "part of a regular business." See 15 U.S.C. § 78c(a)(5)(B). In support of their position, Defendants contend that, even though the SEC alleges that they were engaged in a lucrative business of buying and selling securities and presenting themselves to the public as doing so through a website and other media, something more is required of the SEC's Complaint. They assert that the SEC failed to allege that their conduct meets a laundry list of factors they have culled from various SEC no-action letters and other guidance.

The Court should deny Defendants' motion. First, the SEC's Complaint alleges abundant facts to meet the pleading standards in this Circuit and to conclude, under the plain statutory language, both that Defendants have operated as a dealer and that they violated the statutory requirement to register as such. Second, Defendants' contentions that their conduct must be analyzed in light of a list of factors to determine whether they are in violation of the registration requirement—or they qualify for an exception to the broad language of the dealer statute—would require a factual inquiry that is, at best, premature at the pleadings stage. Finally, Defendants are

simply wrong to assert that the SEC's allegations do not allege several of the factors they deem essential to determine whether they qualify for the "trader" exception. In fact, the SEC alleged ample facts that demonstrate—pursuant to the plain language of the statute—that Defendants operate a regular business as securities dealers, including by:

- advertising and holding themselves out to the public, through a website, by sponsoring and attending industry conferences, and by paying cold-callers to solicit issuers directly (Compl. ¶ 12);
- buying convertible notes directly from issuers as a principal (Compl. ¶¶ 1, 10-13, 17);
- selling the resulting stock—billions of *newly issued* shares—into the public market (Compl. ¶¶ 1, 10, 17);
- capturing a markup on each sale because of deep conversion discounts Fierro negotiated during the purchase process (Compl. ¶¶ 1, 10-11, 15, 17); and
- engaging in this conduct repeatedly over a period of almost three years, reaping more than $2.3 million in profits from sales of almost 6.5 billion shares of newly issued stock (Compl. ¶¶ 1, 16-18).

Despite Defendants' apparent concessions, which alone suffice under the plain language of the statute to conclude that they meet the broad definition of "dealer," the SEC's Complaint alleges abundant additional facts to easily satisfy even their preferred analysis at the pleading stage and to wholly undermine their conclusory assertions that their conduct falls into the trader exception to the registration requirement. Accordingly, their motion fails.

Defendants make two additional arguments in their motion to dismiss the Complaint, both of which lack merit. First, their attack on the SEC's claim for control person liability rests entirely on their failed attempt to show no underlying violation of the registration requirement.

Second, Defendants advance a conclusory due process challenge that fails because the statute defining "dealer" is clear and unambiguous on its face. Accordingly, the Court should deny Defendants' motion.

FACTS

From at least January 2015 through November 2017, Defendants bought and sold billions of newly issued shares of microcap securities (*i.e.*, penny stocks)—and generated millions of dollars from those sales—but failed to comply with the mandatory dealer registration requirements of the Federal securities laws. Compl. ¶1.

Defendants' admitted business model is to buy convertible notes—a type of security—from penny stock issuers, convert the notes into newly issued shares of stock, and sell those shares into the public market at a profit. *Id*. During relevant period, Defendants bought or converted more than 50 convertible notes from more than 20 different penny stock issuers. Compl. ¶¶ 2, 17. Defendants demanded and received highly favorable terms for these notes, including deep conversion discounts from the prevailing market price. Compl. ¶¶ 1, 10-11, 15, 17). By engaging in this conduct as a regular business—including by selling the resulting newly issued shares of microcap stock into the public market—Defendants generated more than $2.3 million in profits. Compl. ¶¶ 1-2, 17-18.

Defendant Fierro, the President of JDF Capital, Inc., personally negotiated the terms of the convertible notes that JDF purchased from penny stock issuers (as well as amendments to the original terms). Compl. ¶¶ 5, 11. As a result of Fierro's negotiations, Defendants generally received very favorable terms from the issuers. On behalf of JDF, Fierro signed the securities purchase agreements by which JDF acquired the convertible notes. Compl. ¶ 11.

Defendants held themselves out to the public and operated as an entity willing to buy convertible notes at a regular place of business, which is located in Freehold, New Jersey. Compl. ¶ 12. For instance, Fierro operated a website for JDF that advertised its business to issuers using the Freehold, New Jersey address. *Id.* Additionally, on behalf of JDF, Fierro hired and personally supervised independent contractors, who worked on commission, to solicit issuers who were willing to sell convertible notes to JDF. *Id.* Fierro and others associated with JDF also attended, and sometimes sponsored, conferences at which they solicited penny stock issuers in person. Fierro personally supervised all of JDF's independent contractors who were working to locate issuers who were willing to sell convertible notes to JDF. *Id.* Fierro and the other employees and consultants of JDF worked at JDF's office in Freehold, New Jersey. Compl. ¶ 15. JDF associated with Fierro's brother-in-law, Mark Lefkowitz, a convicted felon (for conspiracy to commit securities fraud) who has been barred by both the SEC and FINRA from associating with a broker-dealer. Compl. ¶¶7, 19. Fierro allowed Lefkowitz, despite his past, to act as a "consultant" for JDF, where among other duties, Lefkowitz participated in JDF's negotiations to buy convertible notes from penny stock issuers. Compl. ¶19.

Defendants obtained nearly all of the stock that they sold in their business directly from the issuers, through note conversions, and not from purchases in the secondary market. Compl. ¶ 13. The shares were newly issued, and selling them in the market significantly increased both the amount of shares in the hands of the public and the issuers' outstanding unrestricted share totals. *Id.* The convertible notes that JDF bought from the issuers entitled Defendants to receive issuer stock at a substantial discount from the prevailing market price. Compl. ¶ 15. Each note provided for a specified discount, which generally ranged between 35 and 50 percent less than the lowest closing price for the stock during the 10 to 25 trading days preceding the conversion

request. *Id.* Defendants, after waiting six months (to comply with the unregistered securities holding period pursuant to Rule 144), sold the stock immediately after converting it, which allowed them to lock in the gains from the discounted share price. Comp. ¶¶ 14-15. The vast majority of Defendants' profits resulted from the discounted prices at which they acquired shares from the issuers to sell into the market, rather than by appreciation of the shares of stock through market forces. Comp. ¶¶ 10, 15, 17-18.

Defendants' business was lucrative and prolific. During the period covered by the Complaint, Defendants bought convertible notes from more than 20 penny stock issuers, sold almost 6.5 billion newly issued shares of the issuers' stock into the public market, and generated more than $2.3 million in profits, the vast majority of which came from the spread, or difference, between the discounted price Fierro negotiated and the prevailing market price. Comp. ¶¶ 2, 10, 13, 12, 15-18.

STATUTORY SCHEME

A. Dealer Registration Under The Exchange Act

Dealers act as essential intermediaries between the investing public and the securities markets. They are gatekeepers, and one of their most important responsibilities is to ensure that they are not participating in an unregistered public offering of securities, "particularly in situations where the securities are those of relatively obscure and unseasoned companies"—*i.e.* microcap securities. *Distribution by Broker-Dealers of Unregistered Securities*, Release No. 4445,1962 WL 69442, at *1 (Feb. 2, 1962).

Issuers in the microcap space are varied. Some are small businesses; others are shell companies engaged in no business at all. *See In the Matter of Bravo Enter. Ltd.*, Release No. 34-75775, 2015 WL 5047983, at *5 (Aug. 27, 2015). Microcap stocks

typically trade in low volumes, are closely held, are highly volatile, and are not typically followed by mainstream analysts and the press, making "[a]ccurate information … difficult to locate for anyone who is not an insider." *Id*. This lack of information makes penny stocks unusually susceptible to fraud, manipulation, and abuse. *Id.*; *SEC v. China Energy Sav. Tech., Inc.*, 2009 WL 875997, at *4 (E.D.N.Y. Mar. 27, 2009).

For these reasons, the gatekeeper role entrusted to dealers is particularly essential in the microcap space because unregistered offerings deprive investors of the information and transparency mandated by the Act.

In light of their importance to the securities markets, persons who act as "dealers" must register with the SEC unless they are specifically exempt from registration. *Warfield v. Alaniz*, 569 F.3d 1015, 1024-25 (9th Cir. 2009); *see also* Exchange Act Section 15(a)(1), 15 U.S.C. § 78o(a)(1) (prohibiting a broker or dealer from using the mail or any other instrumentality of interstate commerce "to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless "registered in accordance with [Section 15(b) of the Exchange Act]"). This registration requirement "serves as the keystone of the entire system of broker-dealer regulation." *Roth v. SEC*, 22 F.3d 1108, 1109 (D.C. Cir. 1994) (cites and quotes omitted); *Eastside Church of Christ v. National Plan, Inc.*, 391 F.2d 357, 362 (5th Cir. 1968).

B. What Is A Dealer?

The Exchange Act defines a dealer as "any person engaged in the business of buying and selling securities … *for such person's own account*." Section 3(a)(4)(A), 15 U.S.C. §78c(a)(5)(A) (emphasis added). This statutory definition was "drawn broadly by Congress to encompass a wide range of activities involving investors and securities markets." Registration Requirements for Foreign broker-Dealers, Release No. 34-27017, 54 Fed. Reg. 30013, 30015

(July 18, 1989).[1] Having a broad definition of "dealer" advances the Exchange Act's investor-protection imperative because registration requirements allow that "discipline may be exercised over those who may engage in the securities business and by which necessary standards may be established with respect to training, experience, and records." *Reg'l Props., Inc. v. Fin. and Real Estate Consulting Co.*, 678 F.2d 552, 561 (5th Cir. 1982) (citation and quotation marks omitted); *see also Roth*, 22 F.3d at 1109 (D.C. Cir. 1994).

Courts and the SEC consider a totality of conduct to determine when a person or entity is "engaged in the securities business" and "buying and selling for his own account." *See In the Matter of Gordon Wesley Sodorff, Jr.,* Release No. 31134, 1992 WL 224082, at *4-5 (Sept. 2, 1992). "T]he primary indicia . . . that a person has 'engaged in the business' . . . is that the level of participation in purchasing and selling securities involves more than a few isolated transactions." *Id*. at *4; *see SEC v. Kenton Capital, Ltd*., 69 F. Supp. 2d 1, 12 (D.D.C. 1998) ("regularity of participation is the primary indicia of being 'engaged in the business'"); *SEC v. River North Equity LLC, et al*., 415 F.Supp.3d 853 (N.D. Ill. 2019) (denying motion to dismiss against convertible note holder that the Commission alleged to have operated as an unregistered securities dealer where defendant sold billions of shares of newly issued stock after converting); *Eastside Church of Christ*, 391 F.2d at 361 (finding Defendant was a dealer because it purchased many church bonds prior to the ones in question for its own account as part of its regular business and sold some of them).

The term dealer does not encompass a person who buys or sells securities "not as a part of a regular business," 15 U.S.C. § 78c(a)(5)(B). This is frequently referred to as the trader exception. Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities

Exchange Act of 1934, Release No. 34-46745, 67 FR 67496-01, 67498-99 (Nov. 5, 2002) (notice of proposed rulemaking). The totality of one's activities determines which side of the dealer/trader line one falls. *Id.* The purpose of the trader exception is to "exclude from the definition of 'dealer' members of the public who buy and sell securities for their own account as ordinary traders," even though their trading may involve more than isolated transactions. *Gordon Wesley Sodorff*, 1992 WL 224082, at *5.

A person generally falls on the dealer side of the line when they hold themselves out to a regular clientele as regularly buying and selling securities at an established place of business. *See* Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, SEC Release No. 34-47364 (Feb. 13, 2003), 2003 WL 328058, at *4 ("Bank Exemptions Adopting Release"). Similarly, participating in the sale or public distribution of new issuances of securities is a dealer function. *Id.* Moreover, when a person's trading profits do not "result from appreciation in the value of the securities," but rather from a markup over the price paid to acquire the securities, the person is likely to be engaged in dealer activity as opposed to ordinary trading.[1] *Gordon Wesley Sodorff*, 1992 WL 224082, at *5.

[1] *See also* SEC, Staff Study on Investment Advisers and Broker-Dealers at 10-11 (Jan. 2011), http://www.sec.gov/news/studies/2011/913studyfinal.pdf [Study on Investment Advisers and Broker-Dealers] ("Generally, the compensation in a broker-dealer relationship is transaction-based and is earned through commissions, mark-ups, mark-downs, sales loads or similar fees on specific transactions, where advice is provided that is solely incidental to the transaction.");Thomas Lee Hazen, 5 Law of Securities Regulation § 14.54 (May 2019) (the Exchange Act's "registration requirements, as well as the definitions of broker and dealer, are drafted broadly"); Colby, *Broker-Dealer Regulation*, § 2:2 ("The courts and the SEC have taken an expansive view of the scope" of the terms "broker," "engaged in the business" and "effecting transactions.").

LEGAL STANDARD

Federal Rule of Civil Procedure 8(a)(2) requires only "'a short and plain statement of the claim showing that the pleader is entitled to relief,' in order to 'give the defendant fair notice of what the ... claim is and the grounds upon which it rests.'" *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (quoting *Conley v. Gibson*, 355 U.S. 41, 47 (1957)).

This Court conducts a three-part analysis when considering a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6). *See Malleus v. George*, 641 F.3d 560, 563 (3d Cir. 2011). The Court must take note of the elements a plaintiff must plead to state a claim; review the complaint to strike conclusory allegations; and accept as true all of the plaintiff's well-pled factual allegations while "construe[ing] the complaint in the light most favorable to the plaintiff." *Id.*; *Fowler v. UPMC Shadyside*, 578 F.3d 203, 210 (3d Cir. 2009) (citation omitted). The Court must determine "whether the facts alleged in the complaint are sufficient to show that the plaintiff has a 'plausible claim for relief.'" *Fowler*, 578 F.3d at 211 (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009)). A facially plausible claim "allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* at 210 (quoting *Iqbal*, 556 U.S. at 678).

ARGUMENT

A. The SEC's Complaint amply alleges that JDF and Fierro were unregistered dealers under the plain language of the statute.

The dispositive question is whether the SEC has alleged facts to demonstrate—pursuant to the plain language of the statute—that Defendants were "engaged in the business" of buying and selling securities without having registered with the SEC. 15 U.S.C. § 78c(a)(5)(A). The Complaint describes in detail how Defendants operated a lucrative and prolific securities business, the very purpose of which was to buy convertible notes from penny stock issuers,

convert them to shares, and sell those *newly issued* shares into the market. These facts—particularly when coupled with the SEC's allegations that Defendants advertised their services and otherwise solicited third parties as part of their business model—amply demonstrate that Defendants were acting as unregistered dealers under the plain language of the statute.[2]

The SEC's Complaint alleges that Defendants bought more than 50 convertible notes from more than 20 different penny stock issuers and sold almost 6.5 billion shares of stock they derived from the notes. Compl. ¶¶ 2, 10. Defendants' ten highest grossing stocks generated profits of more than $2.3 million. *Id*. ¶ 18. These numbers demonstrate that Defendants' extensive participation in the public market "involve[d] more than a few isolated transactions." *Gordon Wesley Sodorff*, 1992 WL 224082, at *4. Even Defendants' own selective recitation of the Complaint's allegations shows that the SEC alleges that they (1) operated a "lucrative" business buying and selling securities, (2) "'held themselves out to the public as being willing to buy convertible notes at a regular place of business," (3) "operated a website for JDF [Capital] that advertised its business to issuers[,]" and (4) "also attended, and sometimes sponsored, conferences at which they solicited . . .issuers in person." Defendants JDF Capital, Inc., And John D. Fierro's Memorandum In Support Of Motion To Dismiss Plaintiff's Complaint ("Mot. Dismiss") at 2.

The SEC's allegations relating to the volume and profitability of Defendants' purchases and sales of securities (Compl. ¶¶ 1, 10-13, 17)—particularly when coupled with the detailed allegations about how Defendants advertised their securities business to third parties (Compl. ¶

[2] In interpreting any statute, courts begin with the plain language of the statute itself. *Kaiser Aluminum & Chem. Corp. v. Bonjorno*, 494 U.S. 827, 835 (1990); *In re Segal,* 57 F.3d 342, 345 (3d Cir. 1995) ("[W]e begin with the familiar canon that the starting point for interpreting a statute is its plain language.") (citations omitted).

12)—alone are adequate to meet the pleading standard under the plain language of the statute and to conclude that they were "engaged in the business" of dealing securities. *See River North*, 415 F.Supp.3d at 858 (holding SEC allegations that defendant bought and sold billions of shares of stock from microcap issuers, quickly resold them to the investing public, and received millions of dollars in profit rendered it "more than plausible" defendant met the statutory dealer definition.); 15 U.S.C. § 78c(a)(5)(A) (a dealer is "any person engaged in the business of buying and selling securities … for such person's own account through a broker or otherwise").

Defendants assert, however, that they qualify for an exception to the plain language of the statute. They ask the Court to engage in a factual inquiry (based upon their laundry list of factors) to determine under the totality of their conduct that they acted as ordinary traders rather than dealers. Such an inquiry is not appropriate at this stage of the proceedings and where, as here, the SEC has adequately pled the elements of the violation. Nonetheless, as discussed below, and contrary to Defendants' conclusory—and often factually incorrect—contentions, the SEC's Complaint pleads more than sufficient facts to establish that they do not in any way qualify for the "trader" exception.

B. Defendants' contentions about the "trader" exception are factually wrong and at best premature.

As a preliminary matter, because Defendants do not meaningfully contest that the SEC adequately alleges that they meet the broad definition of dealer under the plain language of the Exchange Act, the Court should find that "the facts alleged in the complaint are sufficient to show that the plaintiff has a 'plausible claim for relief[]" and deny the motion. *Fowler*, 578 F.3d at 211; *see also River North*, 415 F.Supp.3d at 858 (finding it "more than plausible" defendant met the statutory dealer definition based on regularity and volume of activity buying and selling penny stock).

Defendants contend in their motion to dismiss that: (1) they qualify for the "trader" exception to the dealer registration requirement, and (2) the SEC "has not alleged otherwise." Mot. Dismiss at 5. They are wrong on both counts.

To qualify for the "trader" exception, Defendants must show that even if they engaged in the business of buying and selling securities, they did not do so as "part of a regular business." *See* 15 U.S.C. § 78c(a)(5)(B). On their face, the words "regular business" would reasonably include anyone who has operated a company at a regular place of business that offers services to the public for a profit, as the SEC appropriately alleged Defendants did in its Complaint. *See* Compl. ¶¶ 2, 5, 6, 10, 12, 15-18. Nevertheless, the courts and the Commission have, over time, applied certain factors to distinguish dealers from traders.

In support of their position that they are traders rather than dealers, Defendants selectively cite the Complaint and a laundry list of factors they have culled primarily from decades-old letters the SEC sent in cases in which staff would have declined to recommend enforcement action[3] ("no-action letters"), as well as from other SEC guidance and judicial decisions. The problem for Defendants here is twofold. First, they take issue with the Complaint only as to factors that they claim do not apply to them; this sort of cherry-picking does not aid them generally because the inquiry does not turn on whether activity meets every factor on a laundry list of factors. *See* Mot. Dismiss, at 8-9; *River North*, 415 F.Supp.3d at 857 (stating, "[T]he presence of even a single factor may be enough" to establish that someone is a securities dealer.). Second, Defendants are actually wrong as a matter of fact about which factors the SEC's Complaint alleges.

[3] *See* https://www.sec.gov/fast-answers/answersnoactionhtm.html (description of no-action letters).

In the recent *River North* decision, the United States District Court for the Northern District of Illinois denied a motion to dismiss, rejecting virtually the same contentions Defendants advance in this case:[4]

> River North contends that the SEC has not alleged that River North: extended credit; acted as an underwriter; held itself out publicly as willing to buy or sell securities from its own account on a continuing basis; or carried a dealer inventory of securities. But as the Court stated, these factors (and any decisions construing them) are not controlling. They are neither exclusive, nor function as a checklist through which a court must march to resolve a dispositive motion. And whether and which are met is necessarily a fact-based inquiry best reserved for summary judgment or trial.

415 F.Supp.3d at 858. It is thus immaterial whether the SEC pled that Defendants "handled monies for third-parties, made markets in any security, [or] provided advice." *See* Mot. Dismiss, at 7. The SEC alleged facts sufficient to meet the statutory elements and several *other* factors contained in secondary or tertiary sources, which provide ample legal basis for the SEC's unregistered dealer charges against Defendants.

Contrary to Defendants' conclusory claims (Mot. Dismiss, at 7-9) regarding the SEC's alleged failure to plead that Defendants held themselves out as a business, the SEC pleaded that they "held themselves out to the public as being willing to buy convertible notes at a regular

[4] Notably, despite the striking similarity of the facts and contentions—the latter coming as no surprise because c*ounsel for Defendants drafted the defense's motion to dismiss in River North*—Defendants do not cite the decision. Instead, they rely on a 1996 case from the Western District of New York, dedicating an entire section of their motion to its discussion. Mot. Dismiss, at 9-10. That case, *SEC v. Federated Alliance Group*, 1996 WL 484036 (W.D.N.Y. Aug. 21, 1996), dealt with a fraudulent promotional telemarketing awards scheme and involved a decision at the summary judgment stage. *Id.* It is thus both factually and procedurally inapposite. Moreover, Defendants' reliance on a 24 year-old case, in part, to support their claim that there is a relative dearth of case law on the question of what constitutes dealer activity is not as compelling in light of the cases decided on this issue since 1996. Mot. Dismiss, at 10; *see infra* at 17-18 (citing "dealer" cases).

place of business, which is located in Freehold, New Jersey." Compl. ¶ 12. The Complaint elaborated on this point, stating:

> Fierro operated a website for JDF that advertised its business to issuers using the Freehold, New Jersey address. On behalf of JDF, Fierro hired independent contractors, who worked on commission, to solicit issuers who were willing to sell convertible notes to JDF. Fierro and other associated with JDF also attended, and sometimes sponsored, conferences at which they solicited penny stock issuers in person.

Id. While acknowledging that this language appears in the Complaint, Defendants simply gloss over the significance of the allegations that JDF and Fierro operated a website, paid people to solicit issuers, and sponsored industry conferences where they solicited issuers for business in person. They do not explain why engaging in these activities did not constitute advertising or holding themselves out to the public.

Further, it is unclear how, in light of these allegations, Defendants contend that the "Commission in this matter has only alleged that JDF Capital and Mr. Fierro traded for JDF Capital's own account, and has not alleged that JDF Capital or Mr. Fierro provided any services to third-parties." Mot. Dismiss, at 8. The SEC specifically pleaded that JDF's precise business model was to provide liquidity to penny stock issuers (who were unquestionably third parties) in exchange for convertible notes that permitted JDF to obtain stock at deeply discounted prices and turn a profit by selling newly issued shares into the market. Compl. ¶¶ 2, 10, 15. Defendants' motion is also silent as to what legal authority would render this omission dispositive, even if the Complaint *had* such an omission.

Defendants also contend the SEC failed to plead that they "purchase[d] or [sold] securities as principal from or to customers," as dealers do. Mot. Dismiss, at 8-9. But they are again mistaken. Although it is far from required, the SEC's complaint alleges that Defendants

purchased convertible notes (a form of debt security) directly from issuers (their customers) using JDF's own accounts. Compl. ¶¶ 10, 13. That is obviously trading on a principal basis.

Defendants also argue that in order to be a dealer one must "issue or originate securities" and "participate in a selling group or act as an underwriter," activities which they claim the Complaint does not address. Mot. Dismiss, at 8-9. In guidance released in 2003, the SEC noted that, among other activities, dealers may "participate in the sale or distribution of new issues, such as by acting as an underwriter." *Bank Exemptions Adopting Release*, 2003 WL 328058, at *4. The Complaint expressly alleges that Defendants did so, stating that:

> Defendants obtained nearly all of the stock that they sold in their business directly from the issuers, through note conversions and not from purchases in the secondary market. The shares were *newly issued*, and the sales of the shares in the market significantly increased both the amount of shares in the hands of the public and the issuers' outstanding unrestricted share totals. Selling large quantities of *newly issued* shares into the market is a common attribute of a securities dealer.

Compl. ¶ 13 (emphasis added). In *River North*, the court found similar allegations to be "particularly significant" in holding that the complaint adequately plead the defendant was a dealer. 415 F.Supp.3d at 859. Indeed, in its analysis of River North's status as a dealer, the court observed that the defendant "purchased stocks at a discounted price directly from numerous issuers . . . (instead of purchasing stocks already in the marketplace, like a trader)." *Id.* The court also focused on the discount that River North used to generate a markup when it sold shares derived from convertible notes, underscoring that River North "turned a profit not from selling only after market prices increased (like a trader), but rather from quickly reselling at a marked-up price." *Id*. (citing *Gordon Wesley Sodorff,* 1992 WL 224082, at *5 ("Unlike an investor or trader, Sodorff's profits did not result from appreciation in the value of the securities, but rather from his markup over the price he paid.")). The SEC alleges that Fierro and JDF engaged in the same conduct here:

> The convertible notes that JDF bought from the issuers entitled Defendants to receive issuer stock at a *substantial discount* from the prevailing market price. Each note provided for a specified discount, which generally ranged between 35 and 50 percent less than the lowest closing price for the stock during the 10 to 25 trading days preceding the conversion request. Fierro, who was authorized to trade in JDF's accounts, generally sold the stock immediately after conversion himself, or through an employee acting under his supervision, and thereby locked in his gains . . . . The *vast majority of Defendants' profits resulted from the discounted prices* at which they acquired shares from the issuers to sell into the market. *This mechanism, which gave Defendants a spread (or markup) on the stock that they sold, is a common attribute of a securities dealer*.

Compl. ¶ 15 (emphasis added).

As discussed above, the SEC's allegations amply meet the pleading requirements of Federal Rule of Civil Procedure 8(a) when considered in light of the plain language of the dealer registration statute. Even though Defendants' contentions are, at best, premature,[5] the SEC's allegations wholly undermine any conclusion that they were "simply self-interested market participants." Mot. Dismiss, at 9. The SEC alleges that Defendants: (1) held themselves out to the public by operating a website, paying cold-callers, and sponsoring industry conferences; (2) bought debt securities directly from issuers (acting as principal); (3) converted those debts into newly issued shares of stock; (4) sold the stock into the market for a substantial markup from the prevailing market price; and (5) did so repeatedly. These facts demonstrate the "regularity of [Defendants'] participation in securities transactions" and eviscerate their hollow contention that they were merely acting as traders. The Court should deny Defendants' unsupported motion.

[5] Defendants' factors-based arguments—even if they accurately reflected the content of the Complaint or otherwise had merit—would entail a "fact-based inquiry best reserved for summary judgment or trial." *River North,* 415 F.Supp.3d at 858.

C. Because the SEC has adequately alleged that Defendants acted as unregistered dealers, their derivative control person liability argument necessarily fails.

Defendants seek to dismiss the SEC's allegations regarding control person liability on the grounds that the Complaint does not adequately allege a primary violation of the Exchange Act's dealer registration provisions. Mot. Dismiss, at 10-11. Because the Complaint properly alleges a primary violation, the Court should deny the motion.

D. Defendants' due process challenge lacks merit.

Finally, Defendants' due process challenge—that they lacked any notice that their activities required dealer registration—is meritless. As discussed above, the plain language of the statue is clear and puts Defendants on notice that they were acting as a dealer and were required to register as such.

Their reliance on *Upton v. SEC,* 75 F.3d 92 (2d Cir. 1996), is misplaced. In that case, which was on appeal following a full administrative hearing, "[i]t is undisputed that [respondent] complied with the literal terms of the [SEC] Rule at all times." *Id*. at 94. Nevertheless, the respondent was charged with and found liable, after an evidentiary hearing, for violating the rule based on a new interpretation that had never been communicated to the public, apart from one consent decree carrying "little, if any, precedential weight." *Id*. at 98.

This case in not analogous for several reasons. First, we are at the pleading stage. Second, the SEC's allegations deal with the application of a federal statute, not an agency rule. Third, the plain and unambiguous statutory language requiring dealers to register, including Congress's definition of the term "dealer," have been subject to long-standing interpretation by courts and the SEC. *See SEC v. Big Apple Consulting USA, Inc.,* 783 F.3d 786 (11th Cir. 2015*); Eastside Church of Christ*, 391 F.2d 357 *SEC v. Offill*, 2012 WL 246061 (N.D. Tex. Jan. 26, 2012*); Gordon Wesley Sodorff*, 1992 WL 224082; *In the Matter of Ironridge Global Partners,*

LLC, Release. No. 75272, 2015 WL 3862868 (June 23, 2015) (instituting proceedings under Section 15(b) against unregistered dealer in connection with its serial underwriting activity, providing related investment advice, and receiving and selling billions of shares in connection with self-described financing services for domestic microcap issuers); *see also U.S. v. Coscia*, 866 F. 3d 782, 793 (7th Cir. 2017) (in denying due process challenge to "spoofing" statute, appellate court held that "Congress provided the necessary definition [of spoofing] and, in doing so, put the trading community on notice").

Defendants had fair notice of the dealer registration laws as well as how courts and the SEC have interpreted them. They have not been denied due process.

CONCLUSION

The SEC's Complaint alleges abundant facts for the trier of fact to conclude that Defendants were engaged in the business of buying and selling securities for their own account. Not only does the Complaint go far beyond what is necessary at the pleadings stage to meet the statutory threshold for what constitutes a dealer, it also refutes any possible contention that Defendants were ordinary traders. Their control person argument, which depends entirely upon their Rule 12(b)(6) claims, necessarily fails as well. Finally, because the plain language of the dealer registration requirement in the statute is clear and the SEC and the courts have applied it to unregistered dealers for decades, Defendants' due process claim also fails. Accordingly, the Court should deny their motion.

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Respectfully submitted,

By:

/s/

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CERTIFICATE OF SERVICE

I hereby certify that on June 22, 2020, I filed Plaintiff Securities And Exchange Commission's Opposition To Defendants' Motion To Dismiss through the Court's CM/ECF system, which automatically sends notices to counsel of record in this case.

/s/
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