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9 **UNITED STATES DISTRICT COURT**
10 **CENTRAL DISTRICT OF CALIFORNIA**
11 **Western Division**

12 **SECURITIES AND EXCHANGE**
13 **COMMISSION,**

14 Plaintiff,

15 vs.

16 STEVE CHEN, *et al.*,

17 Defendants.

Case No. CV15-07425 RGK (PLA)

PLAINTIFF SECURITIES AND
EXCHANGE COMMISSION'S
SUPPLEMENTAL MEMORANDUM
ON MONETARY RELIEF

Trial Date: January 10, 2017
Time: 9:00 a.m.
Ctvm: 850
Judge: Hon. R. Garv Klausner

20 **I. INTRODUCTION**

21 This action, brought by the Securities and Exchange Commission ("SEC")
22 against defendant Steve Chen ("Chen") and his related entities in September 2015,
23 concerns a massive pyramid scheme that defrauded myriad investors. On December
24 8, 2016, the Court granted the SEC's motion for summary judgment against Chen,
25 finding him liable on all of the claims asserted against him.

26 On December 19, 2016, the Court held a final pretrial conference to determine
27 whether any triable issues of fact remained for the current January 10, 2017 trial date.
28 After hearing from counsel, the Court found that the only triable issue remaining with

1 respect to Chen was the SEC’s request for monetary relief (*i.e.*, the amount of
2 disgorgement, prejudgment interest, and/or penalty Chen should pay). One question
3 remained, however, on that issue – whether Chen was entitled to a jury trial on the
4 amount of monetary relief or whether the Court could make that determination. So,
5 at the pretrial conference, the Court gave the SEC the opportunity to submit this
6 memorandum to address that question.

7 In short, the law in the Ninth Circuit and elsewhere is clear that the issue of
8 monetary relief in SEC enforcement actions is to be determined by the court, not a
9 jury. The SEC generally seeks two forms of monetary relief in its actions, and this
10 case is no different. One form of relief is disgorgement, which is an equitable form
11 of relief calling for the defendant to return his ill-gotten gains from his fraud.
12 Because it is equitable, by definition, it is to be determined by a court. The other
13 form of relief comes in the form of civil monetary penalties. Both the statutory basis
14 for this form of relief, and the case law addressing that relief, make clear that the
15 penalty determination is also made by the court, not a jury. Therefore, this Court
16 should determine the amount of disgorgement, prejudgment interest, and civil penalty
17 to be imposed against Chen for his fraud. A jury does not decide these issues, and so
18 there are no triable issues remaining in this case for a jury to hear.¹

19 **II. BACKGROUND**

20 The SEC commenced this action against Chen on September 28, 2015. In its
21 complaint, the SEC alleged that he violated the registration and antifraud provisions
22 of the federal securities laws by orchestrating a pyramid scheme that lured investors
23 to invest in US Fine Investment Arts, Inc. (“USFIA”) by falsely claiming, among
24

25 ¹ As stated during the final pretrial conference, the SEC and counsel for the court-
26 appointed Receiver anticipate entering consents and final judgments as to liability
27 and injunctive relief for all of the defendant entities in this action before the January
28 10, 2017 trial date and, once that is completed, will seek a continuance of the trial
date to allow sufficient time to reach an agreement on monetary relief as to those
defendants.

1 other things, that USFIA was conducting a pre-IPO offering of its shares, which Chen
2 claimed were backed by \$50 billion in assets, including vast amber mines located in
3 the Dominican Republic, and by promising investors that when the actual IPO took
4 place in the near future all pre-IPO investors were guaranteed to make at least sixty-
5 four (64) times their initial investment. (Dkt. No. 3.)

6 On December 8, 2016, the Court granted the SEC’s motion for summary
7 judgment as to liability and injunctive relief on all of the SEC’s claims. The Court
8 found that Chen: (1) ran USFIA as a fraudulent pyramid scheme; (2) sold investors
9 securities, whether characterized as investment contracts or pyramid scheme
10 transactions, which were not registered with the SEC; (3) those sales were made
11 though interstate commerce; (4) defrauded investors by failing to advise them that
12 the pyramid scheme was destined to collapse; (5) made five material
13 misrepresentations to investors in connection with the sale of the securities; (6)
14 misused investor funds to fund a lifestyle that included multiple million-dollar
15 mansions and luxury automobiles for him and his family; (7) acted with a high degree
16 of scienter; (8) orchestrated the pyramid scheme over many years; and (9) showed no
17 recognition of wrongdoing and no assurance against future violations. (Dkt. No.
18 167.)

19 **III. ARGUMENT**

20 **A. The Court Determines the Disgorgement Amount**

21 The Court, not a jury, should determine the amount of disgorgement Chen is
22 ordered to pay. As the Ninth Circuit has made clear, disgorgement is a remedy
23 available to the SEC in its enforcement actions:

24 “[A] district court has broad equity powers to order the disgorgement of ill-
25 gotten gains obtained through violation of the securities laws. Disgorgement is
26 designed to deprive a wrongdoer of unjust enrichment, and to deter others from
27 violating securities laws by making violations unprofitable.”

28 *SEC v. Platforms Wireless Int’l Corp.*, 617 F.3d 1072, 1096 (9th Cir. 2010), *quoting*

1 *SEC v. First Pacific Bancorp*, 142 F.3d 1186, 1191 (9th Cir. 1998); *see also SEC v.*
2 *Rind*, 991 F.2d 1486, 1493 (9th Cir. 1993) (disgorgement is an available and
3 appropriate equitable remedy for violations of the securities laws). By preventing
4 unjust enrichment, disgorgement eliminates the incentive for violating the law. *Id.* at
5 1491, 1493; *see also JT Wallenbrock & Assoc.*, 440 F.3d 1109, 1113 (9th Cir. 2006);
6 *First Pacific Bancorp*, 142 F.3d at 1191. “The amount of disgorgement should
7 include all gains flowing from the illegal activities.” *Platforms Wireless*, 617 F.3d at
8 1096, *quoting JT Wallenbrock*, 440 F.3d at 1114; *see also SEC v. Cross Fin. Servs.*,
9 *Inc.*, 908 F. Supp. 718, 734 (C.D. Cal. 1995).

10 Importantly, disgorgement is a form of equitable relief. Disgorgement is not a
11 form of damages, which are designed to compensate fraud victims. Rather,
12 disgorgement forces a defendant to surrender his unjust enrichment. *See Rind*, 991
13 F.2d at 1493. Therefore, as the Ninth Circuit explained in *Rind*, “the fact that
14 disgorgement involves a claim for money does not detract from its equitable nature:
15 in such an action, ‘the court is not awarding damages to which plaintiff is legally
16 entitled but is exercising the chancellor’s discretion to prevent unjust enrichment.’”
17 *Id.* Therefore, a jury does not decide the amount of disgorgement to be awarded in
18 SEC actions. *See id.* (no right to a jury trial in SEC action seeking injunctive and
19 disgorgement relief).²

22 ² The SEC will also request that Chen be ordered to pay prejudgment interest on
23 whatever disgorgement amount the Court imposes. Disgorgement normally includes
24 prejudgment interest to insure that wrongdoers do not profit from their illegal
25 conduct. *See SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1105 (2d Cir.
26 1972); *Cross Fin. Services*, 908 F. Supp. at 734; *see also Platforms Wireless*, 617
27 F.3d at 1099 (affirming calculation of prejudgment based on the rate of interest used
28 by the Internal Revenue Service for the underpayment of federal income tax as set
forth in 26 U.S.C. § 6621(a)(2)). In addition, the SEC anticipates it will request that
Chen and the defendant entities be held joint and severally liable for whatever
disgorgement amount the Court imposes. Joint and several liability is appropriate
when co-defendants “collaborate or have a close relationship in engaging in the
violations of the securities laws.” *See Platforms Wireless*, 617 F.3d at 1098.

B. The Court Determines the Penalty Amount

The Court also determines the amount of penalties to be awarded in an SEC enforcement action. Under Section 20(d)(2)(A) of the Securities Act of 1933 and Section 21(d)(3)(B) of the Securities Exchange Act of 1934, the amount of any civil penalty “shall be determined by the court in light of the facts and circumstances.” 15 U.S.C. §§ 77t(d)(2)(A), 78u(d)(3)(B), 80b-9(e)(1). In other words, the Court “decide[s], consistent with the jury’s finding of liability, not only what equitable relief to impose, but also the amount of civil penalty.” *SEC v. Lipson*, 278 F.3d 656 (7th Cir. 2002); *see also Tull v. United States*, 481 U.S. 412, 427 (1987) (holding that there is only a right to a jury trial on the issue of liability and the “assignment of the determination of the amount of civil penalties to trial judges ... does not infringe on the constitutional right to a jury trial. Since Congress itself may fix the civil penalties, it may delegate that determination to trial judges.”); *United States v. Duffy*, 550 F.2d 533, 534 (9th Cir. 1977) (finding that assessment of civil penalties is for the judge to decide rather than the jury); *SEC v. Capital Solutions Monthly Income Fund, L.P.*, 2016 U.S. App. LEXIS 4697 *20 (8th Cir. 2016) (rejecting a defendant’s challenge to the verdict form and holding that the defendant, “was not entitled to have the jury decide the remedies”).

C. The Standards for the Court’s Determination of Disgorgement and Penalties

1. Disgorgement

When a district court is calculating disgorgement in offering fraud cases in SEC actions, there are three important principles. First, the disgorgement amount should be the “total proceeds” raised by the defendants in the offering, including offering proceeds received by entities owned or controlled by the defendants, minus amounts defendants returned to investors. *See SEC v. Platform Wireless Int’l Corp.*, 617 F.3d at 1096 (“total proceeds . . . [is] a reasonable approximation of the profits obtained from [defendants’] unlawful sales.”); *SEC v. Manor Nursing Ctrs., Inc.*, 458

1 F.2d 1082, 1104 (2d Cir. 1972) (“We hold that it was appropriate for the district court
 2 to order [defendants] to disgorge the proceeds received in connection with the
 3 [securities] offering.”); *SEC v. Interlink Data Network of Los Angeles, Inc.*, No. 93
 4 3073 R, 1993 U.S. Dist. LEXIS 20163 at *53-54 (C.D. Cal. Nov. 15, 1993) (ordering
 5 disgorgement of gross amount received from fraudulent securities offering);³

6 Second, the burden on the SEC in establishing the disgorgement amount is not
 7 high. The SEC need only present evidence of a “reasonable approximation” of the
 8 defendant’s ill-gotten gains. *See Platforms Wireless*, 617 F.3d at 1096; *JT*
 9 *Wallenbrock*, 440 F.3d at 1113-14. Once such evidence has been presented by the
 10 SEC, the burden shifts to the defendant to “demonstrate that the disgorgement figure
 11 was not a reasonable approximation.” *Platforms Wireless*, 617 F.3d at 1096, quoting
 12 *SEC v. First City Financial Corp., Ltd.*, 890 F.2d 1215, 1232 (D.C. Cir. 1989). This
 13 burden, as the Ninth Circuit explained, is rightfully placed on the wrongdoer:

14 We place this burden on the defendants because information is not “obtainable
 15 at negligible cost.” The defendants are more likely than the SEC to have access
 16 to evidence [demonstrating that the SEC’s approximation is not reasonable]. . . .
 17 [W]e conclude that “the risk of uncertainty should fall on the wrongdoer whose
 18 illegal conduct created that uncertainty.”

20
 21 ³ See also *SEC v. Robinson*, 2002 WL 1552049 *9 (S.D.N.Y. Jul. 16, 2002) (“[I]t is
 22 appropriate to order disgorgement of the entire (gross) proceeds received in connection with
 23 the offering.”); *SEC v. Rosenfeld*, 2001 WL 118612, *2 (S.D.N.Y. Jan. 9, 2001) (“[O]nce
 24 the Commission shows the existence of a fraudulent scheme . . . the burden shifts to the
 25 defendant to ‘demonstrat[e] that he received less than the full amount allegedly
 26 misappropriated and sought to be disgorged.’); *SEC v. Sahley*, 1994 WL 9682, *1 (S.D.N.Y.
 27 Jan. 10, 1994) (granting the SEC’s motion for summary judgment and ordering
 28 disgorgement of entire \$950,000 raised in the offering fraud; *SEC v. Watermark Financial*,
 2012 WL 501450 (W.D.N.Y. Feb. 12, 2012) (setting disgorgement at \$5.2 million, “the total
 amount still owed [to investors].”); *SEC v. Pittsford Capital Income Partners, L.L.C.*, 2007
 WL 2455124, *16 (W.D.N.Y. Aug. 23, 2007) (agreeing with the Commission’s calculation
 and setting disgorgement at \$11.7 million; *i.e.*, the total amount raised in the fraudulent
 offering minus the amount of funds returned to investors), *aff’d in part*, *SEC v. Pittsford*
Capital Income Partners, L.L.C. 305 Fed. Appx. 694 (2d Cir. 2008) (unpublished
 disposition).

1 *Id.*, quoting *First City Financial Corp.*, 890 F.2d at 1231-32.

2 This shifting burden on the defendant is important here. As the SEC
3 previously pointed out in its motion *in limine* (Dkt. No. 148), Chen should be barred
4 from offering any affirmative evidence contesting the SEC's disgorgement figure, as
5 calculated by the court-appointed receiver, based on the fact that he asserted his Fifth
6 Amendment right against self-incrimination in refusing to comply with the Court-
7 ordered accounting (Dkt. No. 17), and continued to assert his Fifth Amendment rights
8 in response to every substantive question at his deposition. *See e.g. SEC v. Benson*,
9 657 F.Supp. 1122, 1129 (S.D.N.Y. 1987) (precluding defendant from offering
10 evidence in support of positions on which he declined to furnish disclosure on the
11 basis of Fifth Amendment); *SEC v. Cymaticolor Corp.*, 106 F.R.D. 545 (S.D.N.Y.
12 1985) (granting total preclusion order that prevented defendant from offering into
13 evidence any matter relating to the factual bases for his denials and defenses as to
14 which he had asserted his Fifth Amendment rights); *SEC v. Cassano*, No. 99 Civ.
15 3822(LAK) 2000 WL 777930 *1 (S.D.N.Y. 2000) (same); *SEC v. Interlink Data*
16 *Network of Los Angeles, Inc.*, Civ. A. No. 93-3073-R, 1993 WL 603274 *8 n.97
17 (C.D. Cal. 1993) ("In those instances in which a party asserts the Fifth Amendment
18 across-the-board in civil litigation to prevent an opponent from obtaining any
19 discovery at all of evidence of the facts at issue and of the position of the party
20 invoking the privilege on those facts, the injustice of allowing that party to put on
21 evidence at a hearing or trial on the same facts is especially manifest.").

22 Indeed, because Chen's ability to challenge the SEC's evidence with respect to
23 the issue of monetary relief is so limited, the SEC respectfully submits that a trial or
24 evidentiary hearing before the Court is not even necessary. Instead, the Court should
25 reinstate the provision of its summary judgment order that provided "the amounts of
26 the disgorgement and civil penalty" would be decided "upon motion of the
27 Commission." (Dkt. No. 168, p. 3.) This would be consistent with the Court's
28 previous ruling in this case, its rulings in other cases, and Ninth Circuit precedent.

1 (Dkt. No. 167, p. 4.) (Chen may not discharge his burden by “merely attack[ing] or
2 discredit[ing] the movant’s evidence.”) (*citing Nat’l Union Fire Ins. Co. v. Argonaut*
3 *Ins. Co.*, 701 F.2d 95, 97 (9th Cir. 1983); *see also, SEC v. Colello*, 139 F.3d 674, 678
4 (9th Cir. 1998) (affirming grant of summary judgment, ordering defendant to
5 disgorge over \$2.6 million, where defendant had asserted Fifth Amendment
6 privilege); *SEC v. Coldicutt*, CV 13-01865-RGK (VBKx), 2014 WL 12561072, *6-8
7 (C.D. Cal. 2014); *SEC v. LADP Acquisition, Inc.*, CV 10–6835 RGK (JCGx), 2011
8 WL 3861581 *1-2 (C.D. Cal. 2010).

9 **2. Penalties**

10 Finally, as for the Court’s determination of the penalty amount, district courts
11 (and not juries) generally apply the factors set forth in *SEC v. Murphy*, 626 F.2d 633
12 (9th Cir. 1980). These factors are also used to establish the need for injunctive relief,
13 and are used in penalty determinations because civil penalties, like permanent
14 injunctions, are imposed to deter the wrongdoer from similar conduct in the future.
15 *See, e.g., SEC v. Wilde*, No. SACV 11-0315 (DOC (AJWx), 2012 WL 6621747, *15-
16 16 (C.D. Cal. Dec. 17, 2012); *SEC v. Abacus Int’l Holding Corp.*, No. C 99–02191,
17 2001 WL 940913, at *5 (N.D. Cal. Aug.11, 2001). The *Murphy* factors are: (i) the
18 degree of scienter involved; (ii) the isolated or recurrent nature of the infraction; (iii)
19 the defendant’s recognition of the wrongful nature of his conduct; (iv) the likelihood,
20 because of the defendant’s professional occupation, that future violations might
21 occur; and (v) the sincerity of his assurances against future violations. *See Murphy*,
22 626 F.2d at 655; *see also CMKM Diamonds*, 635 F. Supp. 2d at 1192.

23 The Securities Act and the Exchange Act provide that penalties should be
24 assessed according to a three-tier system. *See* 15 U.S.C. §§ 77t(d)(2), 78u(d)(3)(B),
25 80b-9(e)(2). First-tier penalties may be imposed for any violation of any Act. *See id.*
26 §§ 77t(d)(2)(A), 78u(d)(3)(B)(i), 80b-9(e)(2)(A). Second-tier penalties apply to
27 violations that “involved fraud, deceit, manipulation or deliberate or reckless
28 disregard of a regulatory requirement.” *Id.* §§ 77t(d)(2)(B), 78u(d)(3)(B)(ii), 80b-

1 9(e)(2)(B). Third-tier penalties apply to violations that (i) involve “fraud, deceit,
2 manipulation, or reckless disregard of a regulatory requirement” and (ii) “directly or
3 indirectly resulted in substantial losses or created a significant risk of substantial
4 losses to other persons.” *Id.* §§ 77t(d)(2)(C), 78u(d)(3)(B)(iii), 80b-9(e)(2)(C). Each
5 tier provides that a penalty cannot exceed the greater of either a specific statutory
6 amount, or “the gross amount of pecuniary gain to such defendant as the result of the
7 violation.” *Id.* §§ 77t(d)(2), 78u(d)(3)(B), 80b-9(e)(2).

8 Here, the Court’s findings on summary judgment will likely play a key role in
9 determining the appropriate penalty level and amount. By way of example, the Court
10 found that Chen (1) ran USFIA as a fraudulent pyramid scheme; (2) defrauded
11 investors by failing to advise them that the pyramid scheme was destined to collapse;
12 (3) made five material misrepresentations to investors in connection with the sale of
13 the securities; (4) misused investor funds to fund a lifestyle that included multiple
14 million-dollar mansions and luxury automobiles for him and his family; (5) acted
15 with a high degree of scienter; (6) orchestrated the pyramid scheme over many years;
16 and (7) showed no recognition of wrongdoing and no assurance against future
17 violations. (Dkt. No. 167.) These now undisputed facts all weigh in favor of sizable
18 penalties.

19 **IV. CONCLUSION**

20 Based on the foregoing, the SEC respectfully submits that it is the Court, not a
21 jury, who should decide the issue of monetary relief in this case, namely, whether
22 Chen should be ordered to pay a disgorgement amount plus prejudgment interest and
23 a civil penalty.

24
25 Dated: December 21, 2016

26 */s/ Douglas M. Miller*
27 _____
28 DOUGLAS M. MILLER
Attorney for Plaintiff
Securities and Exchange Commission

PROOF OF SERVICE

I am over the age of 18 years and not a party to this action. My business address is:

U.S. SECURITIES AND EXCHANGE COMMISSION,
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On December 21, 2016, I caused to be served the document entitled **PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S SUPPLEMENTAL MEMORANDUM ON MONETARY RELIEF** on all the parties to this action addressed as stated on the attached service list:

OFFICE MAIL: By placing in sealed envelope(s), which I placed for collection and mailing today following ordinary business practices. I am readily familiar with this agency's practice for collection and processing of correspondence for mailing; such correspondence would be deposited with the U.S. Postal Service on the same day in the ordinary course of business.

PERSONAL DEPOSIT IN MAIL: By placing in sealed envelope(s), which I personally deposited with the U.S. Postal Service. Each such envelope was deposited with the U.S. Postal Service at Los Angeles, California, with first class postage thereon fully prepaid.

EXPRESS U.S. MAIL: Each such envelope was deposited in a facility regularly maintained at the U.S. Postal Service for receipt of Express Mail at Los Angeles, California, with Express Mail postage paid.

HAND DELIVERY: I caused to be hand delivered each such envelope to the office of the addressee as stated on the attached service list.

UNITED PARCEL SERVICE: By placing in sealed envelope(s) designated by United Parcel Service ("UPS") with delivery fees paid or provided for, which I deposited in a facility regularly maintained by UPS or delivered to a UPS courier, at Los Angeles, California.

ELECTRONIC MAIL: By transmitting the document by electronic mail to the electronic mail address as stated on the attached service list.

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I declare under penalty of perjury that the foregoing is true and correct.

Date: December 21, 2016

/s/ Amanda C. Liston

Amanda C. Liston

1 **SEC v. Steve Chen, USFIA, Inc., et al**
2 **United States District Court – Central District of California**
3 **Western Division**
4 **Case No. CV 15-07425 (RGK)(GJSx)**
5 **LA-4482**

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