NOT YET SCHEDULED FOR ORAL ARGUMENT

United States Court of Appeals for the District of Columbia Circuit

No. 09-1260

MARTIN A. ARMSTRONG

Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review from Securities and Exchange Commission in No. SEC-3-13121

BRIEF FOR PETITIONER

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

I. PARTIES

Martin A. Armstrong ("Armstrong") is the petitioner, who was respondent below in the administrative proceedings brought by the United States Securities and Exchange Commission ("SEC" or "Commission"), the respondent in the proceedings before this Court.

II. RULINGS UNDER REVIEW

Armstrong petitions for review of the SEC's opinion and final order of September 17, 2009. JA

III. RELATED CASES

The SEC's final order has not previously been before this Court for review. However, Armstrong, while incarcerated, filed numerous motions and briefs in *Martin A. Armstrong v. Harley G. Lapin, Director of the Federal Bureau of Prisons ("BOP")*, Docket No. 09-5370. The several motions in that case were consolidated and referred to a special motions panel in this court and denied.

/s/ Thomas V. Sjoblom
Thomas V. Sjoblom

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GLOSSARY

Alloc	Allocution of Petitioner
Comex	Commodities Exchange
CME	Chicago Mercantile Exchange
Commission	Securities and Exchange Commission
Cresvale	Cresvale International Ltd
Cresvale Tokyo	Cresvale International Ltd, Tokyo Branch
DOJ	Department of Justice
FSA	Financial Supervisory Authority in Japan
JA	Joint Appendix
JMOF	Japanese Ministry of Finance
NYMEX	New York Mercantile Exchange
PEI	Princeton Economics International
PGM	Princeton Global Management
Republic Bank	Republic New York Bank
Republic Philadelphia	Republic Securities Corporation, Futures Division
RNYSC	Republic New York Securities Corporation
SDNY	Southern District of New York
SI	Superseding Indictment
USAO	United States Attorneys Office

JURISDICTIONAL STATEMENT

Jurisdiction of the SEC's administrative proceeding below was based on Section 203(f) of the Investment Advisers Act of 1940, 15 U.S.C. §80b-3, and this petition of the SEC's final order is authorized by Section 213 of the Investment Advisers Act of 1940, 15 U.S.C. §80b-13.

STATEMENT OF ISSUES PRESENTED

1. Whether Petitioner Armstrong has been denied due process of law in connection with the multiple criminal and civil proceedings in this case?

2. Whether there is substantial evidence in the record and whether the Commission reached its conclusions of law arbitrarily or unwarranted under applicable legal standards to support the Commission's administrative bar order issued in this case?

STATEMENT OF THE CASE

This case is the zenith of multiple and parallel criminal, civil and administrative proceedings -- spanning more than ten years – for conduct that occurred in Japan. They have included the longest running civil contempt in the history of federal jurisprudence, a criminal guilty plea extracted by placing petitioner in the solitary confinement, a SEC civil enforcement proceedings based on conduct for which there is no claim for relief, and an administrative proceeding

predicated on all the foregoing. Throughout all, the government has ignored and violated Petitioner's due process rights.

In June 2010, the United States Supreme Court issued its decision in *Morrison v. National Australia Bank*, 130 S.Ct. 2869 (2010), which held that there can be no claim for relief under the anti-fraud provisions of federal securities laws for deceptive conduct outside the United States because there can be no extraterritorial application of those statutes. After *Morrison*, the government could not bring the criminal or civil enforcement proceedings based on the facts in this case and should not now be permitted to continue to press for further sanctions for such conduct.

Therefore, the Commission's administrative bar order should be set aside and this case dismissed.

STATEMENT OF FACTS

A. The Issuance of Princeton Notes by Foreign Corporations

1. The Princeton Notes

Petitioner Martin Armstrong ("Armstrong") formed Princeton Economic International ("PEI"), a Turks & Caicos company, in 1987. Martin Armstrong Declaration ("MA Declar") ¶ 1. In the early 1990s, Armstrong began dealing with Cresvale International, Ltd, ("Cresvale"), a Cayman Islands corporation, in Japan through the offices of Cresvale's Tokyo Branch (Cresvale-Tokyo"), a registered

broker-dealer in Japan and subsidiary of Cresvale Far East, a company organized under the laws of Hong Kong as a securities broker-dealer. PEI provided Cresvale-Tokyo with forecasting information, which Cresvale repackaged, translated into Japanese, and marketed to Japanese companies. PEI purchased Cresvale-Tokyo in 1995 from Banc Palias in France with the approval of the Hong Kong regulators and Japanese Ministry of Finance ("JMOF").[1] From 1995 to 1999, Armstrong was chairman of Cresvale. *Id.* ¶3.

The note transactions at issue in this case began in or about 1992, when Armstrong was approached at PEI's offices in Japan by Mr. Setogawa, chairman of Cresvale-Tokyo. *Id.* ¶5. Yakult, a Japanese company that had previously obtained a note from Credit Suisse, requested Cresvale -Tokyo to provide a note with a similar structure. Setogawa requested PEI to issue such a note to Yakult. Over time, several other Japanese companies made similar requests of Setogawa to help them recapture the shortfall in their Japanese stock portfolios they had been reporting on their financial statements at historical cost rather than the current lower market values.[2] Under permissible accounting practices in Japan, these

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[1] The Superseding Indictment ("SI") wrongly implied that Armstrong acquired Cresvale to cover up losses. JA(SI ¶ 70 l-m). The internal audit records of Republic Securities Corporation of New York ("Republic Securities") state that Armstrong's note transactions were profitable at least until 1998. JA(M Hershey Ltr).

[2] Approximately 140 companies used the Princeton note program.

companies were not required to report any drop value until the loss was actually taken (*i.e*., the stocks were sold). Instead of incurring a loss, these Japanese companies elected to swap the stocks for a note receivable, which could be carried on their financial statements consistent with existing accounting principles as an asset at the higher historical cost. All notes were marketed by Cresvale-Tokyo in Japan at private meetings by Setagowa. Cresvale-Tokyo was required to obtain the approval of the Japanese Ministry of Finance ("JMOF") to issue the notes to the Japanese companies. *Id.*

PEI engaged in two types of note transactions: variable rate and fixed rate notes. *Id.* ¶6. The variable rate notes, which PEI began issuing in 1992, represented a swap by the Japanese corporations of pre-existing stock portfolios, the market value of which had declined from 40 to 60 percent, for a note. The face value of the note was set at the book value of the portfolio and the two were then swapped. The transaction was complete in Japan. This "swap" was permitted under Japanese law. PEI then liquidated these Japanese stocks in Japan through Cresvale-Tokyo, for which it received Japanese yen. [3] The variable rate notes were

[3] The Japanese Yen received by Cresvale –Tokyo from sale of the stocks was "wired" internally by book entry by Bank of Tokyo in Japan to its New York branch, which in turn wired US Dollars to Republic Bank of New York for further crediting to Republic Securities Corporation in Philadelphia. ("Republic-Philadelphia"). Due to exchange controls, Cresvale -Tokyo was required to obtain the approval of JMOF to make such wires. MA Declar ¶ 7.

redeemable at maturity for their face value (*i.e.,* the book value of the stock portfolio). Since there was no set maturity date by which PEI had to repay the note, the interest rate was variable. JA(Example).

To effectuate each note transaction, PEI, through its affiliate Princeton Global Management ("PGM"),[4] also a Turks & Caicos company, set up a number of off-shore special purpose vehicles ("SPVs") affiliated with PGM, each of which issued the notes. *Id.* ¶ 15.

The fixed rate notes were first issued in 1995 when the Japanese yen reached its historical high against the US dollar. In 1995, PEI was approached by Maruzen, another Japanese company, which proposed to lend PEI approximately $75 million worth of yen. *Id.* ¶ 8. PEI could convert the yen to US dollars and earn a higher interest rate, since the Japanese rates were 0.1 percent compared to 8 percent in US dollars. PEI agreed. The yen declined sharply, resulting in about a $14 million gain in 90 days. PEI split the interest rate, paying 4 percent in yen , which amounted to a 4000 percent increase in the local yen interest rate, and paid 10 percent of the exchange rate gain. *Id.*

The fixed rate notes were not issued in exchange for a stock portfolio, but were simple contract borrowings. JA(Example); *Id.* ¶ 9. Both principal and

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[4] PGM was not set up specifically for these note transactions, as has been implied in these proceedings. Funds management had previously occurred for other well known global financial institutions through PGM. MA Declar ¶ 16.

interest were payable in yen. The notes paid a guaranteed 4 percent rate of interest at maturity, rather than the existing 0.1 yen rate.[5] To earn something higher than the agreed upon 4 percent rate of interest, PEI through Cresvale–Tokyo used these borrowed funds to purchase agency securities issued by the Federal National Mortgage Association ("FNMAs"). *Id.* ¶10-11.[6]

Most of the fixed rate notes, which comprised almost 60 percent of all notes, were issued in the "street name" of Cresavle-Tokyo, as the nominee of the Japanese company. *Id.* ¶ 14. JA(Crm. Cmplnt, ¶¶ 5 a, c.); JA(Prin. note). Indeed, the bulk of the notes were nothing more than book entries at Cresvale-Tokyo. Moreover, most of the notes were never actually issued in Japan until after the SEC Receiver was installed, who requested John Gracy, who ran the Cresvale-Tokyo office, to issue the notes to the Japanese companies. MA Declar. ¶14.

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[5] Although on their face these fixed rate notes thus appeared to carry rates in excess of available yen interest rates — 4 % instead of 0.1 % — this was due to an agreed upon US dollar/ yen exchange rate. The government misstated these notes, analyzing them in US dollars terms and claiming that Armstrong overpaid some note holders when in fact the contract required payment in in yen. MA Declar ¶ 12. Thus, the government changed the base currency to support its allegations of fraud.

[6] An audit by NY Mercantile Exchange confirmed that the accounts were proprietary and that cash was used to buy FNMAs. JA. Republic account statements also verified the purchase of FNMAs, JA , as did an employee of Republic-Futures. MA Declar ¶ 9 .

Armstrong traded in yen futures contracts as a hedge against foreign exchange rate risk.[7] *Id.* ¶¶ 17, 19. Importantly, Armstrong had an unlimited *line of credit from Republic* to use for hedging transactions. *Id.* ¶17; JA(RNYSC 1995 Credit Committee Reports). He also had previous profits to use for hedging. He did not use the proceeds borrowed from the Japanese companies or sale of the portfolios. JA(Rogers Ltr, 3/17/99; Hershey Ltr 3/4/98.) Therefore, there never was any "trading" in the individual PGM accounts as the government has alleged. No profit or loss flowed to any note holder. *Id.* ¶ 17.

There were gains earned from hedging, and Armstrong made profits, at least up through 1998.[8] *Id.* ¶ 19, 21. There also were losses on the futures contracts from hedging, but those losses were offset by the gains made on the cash delivery price of yen at the time of the note's maturity. The government mischaracterized the Princeton note transactions by looking only at one side of the ledger (*i.e.,* the futures position), by ignoring the cash market side of the transactions, and by converting everything from yen to US dollars. *Id.* ¶ 18.

In late 1997 or 1998, because of continuing errors in the PGM accounts at Republic -Philadelphia, Armstrong restricted all trading to eight accounts, one for

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[7] At the time of the TRO in September 1999, the SEC conceded that there were significant yen positions "in the hundreds of millions" of dollars in hedge positions. JA(Tr; 9/13/99, p.6, L14-15).

[8] JA(M Hershey ltr 3/4/98).

each asset class (*e.g.,* metals, currencies, and index futures). *Id.* ¶ 22. Petitioner had not been informed that the officers and employees at Republic –Philadelphia had been using the PGM accounts to trade for their own benefit. *Id.* [9]

The debate in this case should have focused on the $400 million differential between the $1 billion in notes outstanding and the $606 million so-called "loss" that the government used as basis for restitution awards. The government's confusion stems from misperceiving the (a) differential between the original US dollar amounts received at the time of conversion of yen when the notes were issued and the cost to purchase yen to repay the notes, which is profit from the change in the exchange rate at time of issuance and time of repayment, and (b) losses in hedging transactions. [10]

From 1995 to 1998, the yen to dollar conversion rate moved in the direction of the US dollar by about 50 percent (*i.e.,* from 75 yen to 147 yen for $1 US dollars). *Id.* ¶20. [11] When it came time to repay the notes, PEI's cost to purchase yen was thus reduced by 50 percent. By the end of 1998, approximately $2 billion

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[9] In October 1998, when errors continued, Armstrong demanded an audit, suspecting that Republic had been "parking" losing trades in the PGM accounts. MA Declar ¶25.

[10] The confusion was initially put forward by the SEC and CFTC attorneys at the hearing on September 13, 1999 when they confused note holder accounts with hedging transactions. JA(Tr. 7, 13-14.) Yen notes should not have been recast in US dollars terms, materially changing the underlying obligation to allege fraud.

[11] When the yen goes up, it is actually falling in relation to the US dollar.

in notes had been redeemed at a substantial profit to PGM. [12] Accordingly, there never had been any loss on the notes.[13]

2. Involvement of Republic Securities in the Fraud: The NAV Letters and Commingling

In 1995, Armstrong transferred the PGM accounts from Prudential Securities ("Prudential") to Republic- Philadelphia, an affiliate of Republic National Bank of New York ("Republic Bank"). The accounts were handled by William Rogers ("Rogers"), who was president of Republic's Futures Division in Philadelphia.

From 1995 to 1999, PGM opened as many as 450 separate accounts and deposited nearly $3 billion with Republic Securities, which became the custodian of the accounts. Republic- Philadelphia signed fiduciary agreements for each of the accounts, pursuant to which Republic (not PEI or PGM) agreed that the accounts would be segregated in accordance with CFTC regulations but not individually from each other. JA(Fiduc. Agmt); MA Declar. ¶ 36.

From 1995 through most of 1999, Republic Securities issued confirming letters to PGM for each note whenever funds were received from Cresvale-Tokyo. Republic Securities also issued periodic net asset value ("NAV") letters to PGM in

[12] JA(M Hershey Ltr 3/4/98).

[13] Petitioner's accountant found that there were no trading losses on the notes to the degree alleged in the indictment. JA(FCL Ltr).

the Turks & Caicos, which would be provided to Cresvale-Tokyo. On occasion, Cresvale-Tokyo would provide such letters in Japan to a Japanese note holder if requested. None of these letters were issued in the United States to any "investor."

In August 1999, as a result of the letter from the Japanese Financial Supervisory Authority ("FSA"),[14] the regulator of Cresvale-Tokyo, Republic began collapsing accounts and seizing funds in the trading accounts, merging them with the note holder accounts allegedly to cover a disputed deficit. MA Declar ¶¶ 29-30.

By August 27, 1999, the seizure by Republic was complete. On August 30, 1999, counsel for Petitioner notified Dov Schlein, vice chairman and president of Republic National Bank, that the funds needed to be returned in one week; otherwise, as lawsuit would follow. Id. ¶ 29. Overlooking their own internal audit letters, which stated that PGM trading had been profitable through 1998, Republic now claimed that the NAV letters were false and that PGM was not hedged,

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[14] In the spring of 1999, the FSA in Japan, an agency charged with supervising banking and securities activities in Japan, forwarded a request for information to the Board of Governors of the Federal Reserve System. JA(Crim. Cmplnt, ¶ 4). The request stated that, based on the FSA's review of Cresvale- Tokyo, the FSA had determined that Cresvale-Tokyo had sold to Japanese "investors" certain "securities" known as the Princeton Notes with a total face value exceeding $30 billion, of which approximately $10 billion remained outstanding. *Id*. ¶ 4b, note 2; MA Declar ¶ 30. The FSA's letter unleashed a panic of epidemic proportions. On August 31, 1999, after Republic seized the accounts, the FSA sent a letter to Republic to correct the prior figures: the total notes were only $3 billion, with just $1 billion outstanding. MA Declar. ¶ 30.

despite the hundreds of millions of dollars in yen positions. Republic then contacted the CFTC and the SEC.

B. Parallel DOJ and SEC Proceedings

1. Department of Justice Obtains Seizure Warrant

On September 2, 1999, the United States Attorneys Office (" USAO") in the Southern District of New york ("SDNY") obtained from a Magistrate Judge a seizure warrant against an account at Republic Securities in the name of PGM, including "any and all sub-accounts" and "all proceeds traceable thereto." JA(Seizure Warrant).

2. Parallel Criminal and Civil Enforcement Cases

On September 13, 1999, one day after the warrant's ten-day period for seizure of the bank accounts, the USAO in SDNY filed a one count criminal complaint against Armstrong alleging securities fraud. He voluntarily surrendered in Trenton, New Jersey at 4:30 p.m. and was released on bail. MA Declar. ¶¶ 40-41. [15]

[15] Not happy that Armstrong was out on bail, the USAO of SDNY one week later indicted Armstrong to, in effect, "transfer" the case to the SDNY. The indictment alleged a fraud of $750 million.

That same day at 5:00 p.m., the SEC filed its civil enforcement action in the SDNY. [16] While Armstrong was self-surrendering in Trenton, the SEC appeared in the SDNY and obtained a temporary restraining order ("TRO"), freezing all of the defendants' assets and appointing a temporary receiver over them.

a. Subject Matter Jurisdiction and a Claim Raised and Rejected

Contending correctly that the issuance of the Princeton Notes was extraterritorial, Armstrong's counsel moved to dismiss the SEC case for lack of subject matter jurisdiction and for failure to state a claim. JA(TG Mot).

Without analysis, the district court (Judge Owen) simply asserted that the Princeton Notes were "securities." *See SEC v. Princeton Economic Int'l, 73 F. Supp. 2d 420, 422 (S.D.N.Y. 1999*). In denying the motion on grounds of lack of subject matter jurisdiction, Judge Owen said he was relying on the conduct and effects tests. [17] *See SEC v. Princeton Economic Int'l, 84 F. Supp. 2d 452 (SDNY 2000).* The district court found the "conduct test" satisfied because the SEC had alleged in its complaint that petitioner, "from his offices in *Princeton, New Jersey,*

[16] The Supreme Court has stated that it would presumptively be an act of bad faith for a federal agency to commence a related civil proceeding if a criminal prosecution has already been initiated. *Donaldson v United States,* 400 US 517, 536 (1971). This court has also recognized the due process implications of such parallel tactics. *Silver v. McCamey*, 221 F.2d 873, 875 (D.C.Cir. 1955).

[17] The district court did not rely on the "effects test" to support subject matter jurisdiction.

controlled not only PEIL, PGML, and the Turks and Caicos subsidiaries of PEIL that issued the notes to the Japanese investors, but Cresvale as well, the Japanese brokerage firm that marketed the notes." *Id. at 454 (emphasis in original).* The district court also stated that Armstrong may have "directed" trading in the accounts in Japan, may have "caused" certain NAV letters to be sent by Republic to Cresvale-Tokyo, and was a "a substantial or contributing cause of the losses." *Id.*

The district court denied the motion to dismiss for failure to state a claim because Armstrong "and his entities," lost "many million of dollars in risky currency and commodities trading" and commingled those accounts to cover up the losses.

b. Asset Freeze

Disregarding the Supreme Court's 1999 decision in *Grupo Mexicano v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999), which held that no asset freeze can be placed over *unsecured* notes, Judge Owen continued the asset freeze as part of the preliminary injunction. The government acknowledged that the notes were unsecured JA(Crm Cmplnt ¶ 5c), but the district court would not be swayed.

c. SEC Receiver Appointed

To support the government's motion for appointment of a temporary Receiver, SEC counsel claimed that PEI's or PGM's "strategies were extremely

risky, that they lost half a billion dollars in foreign currencies in yen and in index trading. They apparently were not hedged." JA(Tr. pp. 13-14). That was a misstatement. JA(Hershey Ltr 3/4/98); MA Declar 17. The SEC's attorney stated that there were outstanding positions that needed to be managed. The district court granted the SEC's request for a temporary receiver, who then liquidated the entire hedge, incorrectly believing it to be speculation and causing a loss of up to $100 million, even though the hedge was being used to cover the exchange rate risk on the notes.

The Receiver was also permitted to engage in virtually global discovery, including Australia,[18] and entered into an agreement to keep evidence from Armstrong, much of which could have produced Brady materials. [19]

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[18] Such global discovery violated the territorial restrictions on receivers. *Booth v. Clark*, 17 How. 322, 15 L.Ed.64 (1854). As this court noted in *Collins v. MacDonald*, 96 F.2d 258, 259 (D.C.Cir. 1938) , "[t]he functions and authority of such receiver are confined to the jurisdiction in which he was appointed. *** [I]f the powers of chancery receivers are to be enlarged in such wise as to give them authority to sue beyond the jurisdiction of the appointing court, such extension of authority must come from legislation and not from judicial action.'"

[19] On October 7, 1999, the Receiver entered into a Memorandum of Agreement ("MOA") with the joint provisional liquidators ("JPLs") over PEI and PGM in the Turks & Caicos. The MOA reached beyond district court's jurisdiction and contained provisions which violated Armstrong's due process rights. Among them was a provision that prohibited the Receiver and JPLs from providing to Armstrong any information regarding the Princeton companies or their assets, JA(MOA ¶ 13(b)), information which Armstrong needed to defend himself.

d. Armstrong Held in Civil Contempt for Over Seven Years

In the longest running civil contempt in the history of federal jurisprudence in the United States, Armstrong was held at the Metropolitan Correctional Center ("MCC") in New York from January 2000 until April 2007. Judge Owen had determined that Armstrong failed to comply with the asset freeze and turnover order by failing to deliver alleged corporate assets, including a bust, antique coins and gold bars. Even though the contempt statute authorizes no more than an 18-month period of confinement, 28 U.S.C. §1826, Judge Owen ruled that, as a federal district court judge, he had unlimited equitable powers to hold a civil contemnor for life, if need be. [20]

Sometime in summer of 2001, a BOP employee (Oliver Brown) came to Armstrong's cell and informed him that a prosecutor had said that Republic's records were in such bad shape that the government might not be able to its case and needed to break him. MA Declar ¶46.

[20] Following a *habeas* proceeding before Judge Owen, the Second Circuit upheld this unfettered assertion of contempt power. *Armstrong v. Guccione,* 470 F.3d 89 (2d Cir. 2006). Armstrong filed a petition for *certiorari*, but it was denied. 128 S.Ct. 486 (2007).

3. Republic Guilty Plea

In 2001, Republic Securities pled guilty to two counts of securities and commodities fraud for the role of its futures division in Philadelphia in the fraud.[21] Republic acknowledged that its employees overstated the value of assets in the PGM accounts and admitted to commingling client monies.[22] Republic agreed to pay $606 million in restitution to the Japanese companies, a figure based on estimated losses from proprietary commodities trading of $678 million less $72 million in the hands of the Receiver. JA(Tr. Rep. Plea, p. 15). [23] Ultimately, the sentencing court imposed restitution in the amount of $569 million, which the court said was based on the "full amount of the victim's losses minus the victim's anticipated recovery from other sources." JA(Tr. RNYSC, January 2002, pp. 2-3).

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[21] The first count in the indictment alleged a conspiracy ending in August 1999. The second count concerned creation of manipulative and deceptive devises for conduct between September 13 and September 30, 1999, *after* Armstrong had been charged and self surrendered. He therefore could not have been involved in any of this conduct.

[22] In 2004, Rogers plead guilty to commodities and securities fraud for his actions in handling of the PGM accounts. He admitted that he had engaged on behalf of a client in "cherry-picking," placing profitable trades into his personal account after the fact and putting losing trades into PEI's trading accounts. JA(Tr.); MA Declar ¶ 22, 25-26. .

[23] The government mischaracterized this settlement as pertaining to losses in the proprietary trading accounts, when in fact this was the amount needed simply to repay the then face value of the notes, at the current exchange rate, plus interest.

The government acknowledged that this restitution made all of the victims whole. JA(Tr. Rep Plea, pp. 8, 15, 19).[24]

The problem, of course, is that if $606 million made all of the victims whole, why the government alleged that the fraud was initially $30 billion, then reduced it to $3 billion, then to $750 million, then to something approximating $675 million. The answer is that most of the Princeton notes were yen denominated. The yen to US dollar exchange rate moved in favor of the US dollar. JA(Tr.Trenton p. 8). When the value of the contracts were calculated at the time of the Republic guilty plea at the then current yen to US dollar exchange rate, the yen had dropped in value to approximately $650 million US dollars, not $1 billion. JA(Tr. RNYSC sentencing, pp. 2-3, January 2002).[25]

To make up the differential, the Receiver made an interim distribution of $56.6 million from the receivership assets and gave it to Republic. To obtain

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[24] Of the approximately 140 Japanese companies that utilized the Princeton note program, only 57 of the companies were ultimately the subject of the Republic Securities Corporation of New York ("Republic Securities") restitution order. The other companies had already redeemed their notes. Two companies, Maruzen and Jusco, made more profit on their notes than they paid, and Yakult Honsha Ltd., was indicted in Japan for its fictitious accounting practices. JA(Tr. Republic Plea 12/11/01, pp. 12-13).

[25] This raised the possibility that HSBC ultimately benefited from the $394 million difference. MA Declar ¶ 37.

access to that $56.6 million, however, the USAO first had to vacate original seizure warrant. JA(*Vacatur* order).

In 2005, the government announced again that all victims have been made whole. JA.

4. Armstrong's Criminal Plea

a. Armstrong Placed In Solitary Confinement and Forced to Plead Guilty

In the summer of 2006, Armstrong was offered a plea bargain, which he twice refused. He stated that he was entitled to a trial on the charges. MA Declar ¶ 49.

Armstrong was then placed into the Special Housing Unit ("SHU"), known as the "hole," purportedly because he was under "investigation." *Id.* ¶50. [26] When he asked why he was being held in solitary confinement and for how long, Armstrong was told that he was being placed there for 90 days, which could be renewed for another 90 days, for "investigation." When Armstrong told the lieutenant that he had a trial date, he was informed that he would be going to trial from the hole. *Id*. Armstrong asked the lieutenant whether he could call his lawyer, but was told, "Don't worry, [AUSA] Southwell will inform your lawyer that you are going into the hole." *Id.* The USAO was thus fully aware of what was happening.

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[26] The government never made clear why Armstrong was placed in the "hole." The government claimed that some person opened a vent in the main unit at MCC. However, Armstrong was in the law library at the time and not in the vicinity of the event. MA Declar ¶ 50.

After seven days in the hole, Armstrong's counsel were informed that he had been put in the hole but was now being brought into the US Attorneys office to take a plea. *Id.* ¶52. In those meetings, Armstrong was told that if he did not accept the plea agreement, he would go back into the hole and if he insisted on going to trial, the prosecutors would seek a jail term of 135 years. If he accepted the deal, he would be offered a five year jail term, but Armstrong would be permitted to argue to the court that he should be given credit for time served in civil contempt (six and one half years) and to appeal the sentence if that was denied. ¶51.

Armstrong agreed and fully expected his liberty to be restored. He agreed to plead to count one of the superseding indictment which charged him with *conspiracy* to commit securities fraud, commodities fraud and wire fraud in violation of 18 U.S.C. §371.

b. Armstrong's Allocution

Armstrong's allocution before Judge Keenan of SDNY occurred on August 17, 2006. Armstrong was required to read from a prepared script drafted by the USAO. Although he sought to edit that script before the allocution, the USAO denied that request. MA Declar ¶ 54; JA(MA SEC Brf, p. 14).

Since Armstrong had not solicited the Japanese companies and there was an obvious jurisdictional issue, Armstrong was required to state in his allocution that

it was his "agents" in Japan who had done so with his knowledge and on his behalf. JA(Allocution["Alloc."], p. 20). According to the script, these so-called "agents" at Cresvale-Tokyo allegedly had represented to the Japanese companies that the money loaned to PEI and PGM would be segregated from Republic's own trading accounts and not available to Republic for its own use. No one, however, represented that the customer accounts would be segregated from each other. MA Declar ¶ 34.

Obviously concerned about the lack of venue, Judge Keenan asked Armstrong whether there was "[s]ome in Manhattan." Armstrong responded that "the exchange is in New York." JA(Alloc. at 19-20). Armstrong was referring to the Commodities Exchange ("Comex") and the New York Mercantile Exchange ("NYMEX"), where there had in the past been some relatively insignificant commodities or futures contracts traded by PEI and PGM but not in connection with the PGM notes. MA Declar ¶ 55. [27] Although Armstrong also admitted that his proprietary trading had resulted in "millions of dollars of trading losses," *id*. at 20, and even though he admitted that in August 1999 he permitted Republic to merge his eight proprietary trading accounts with the segregated note holder

[27] The overwhelming majority of the hedging transactions were in yen futures traded on the Chicago Mercantile Exchange ("CME").

accounts, these transactions occurred "in connection with trading of *commodity* investments." *Id.* at 22. There were no securities involved.

c. Armstrong's Sentencing

(i) Denial of Credit for Time Served in Contempt

At the allocution, Judge Keenan stated that he would be the person to decide whether Armstrong would be given credit for the time served in civil contempt. JA(Alloc. at 8). At sentencing, however, Judge Keenan reversed course and stated that it was up to the BOP to make that determination. JA(Keenan order). Judge Keenan then sentenced Armstrong to five years imprisonment. But that sentence was to run consecutively following termination of the civil contempt. MA Declar ¶ 60. [28] Judge Keenan thus altered the underlying premise of the plea bargain. *Id*. ¶ 59.

(ii) No Added Restitution

At sentencing, Judge Keenan denied the government's motion for $730 million in restitution, stating that Armstrong had agreed to restitution only in the amount of $80 million. Judge Keenan even altered the amount to $80 million *plus $1 dollar*, to provide Armstrong with the ability to appeal the entire sentence. Two weeks later, the government moved for reconsideration, arguing that Armstrong

[28] Upon termination of the contempt several months later in April 2007 (after having served seven years and three months in the MCC), Armstrong was sent to FCI Fort Dix satellite camp to serve another five years.

should not be permitted to rely on the $606 million paid by Republic under its sentence and be required to pay *another* $80 million in restitution. Judge Keenan denied the motion, stating that "[t]he Court will not change the Judgment in the way the Government urges because the creditors are not entitled to be paid twice." JA(Keenan Order dated April 23, 2007). Judge Keenan also added that, "as the government itself had acknowledged, "it will probably be impossible for Mr. Armstrong to even pay the $80,000,001." *Id.*

5. Settlement with SEC

On July 22, 2008, Judge Castel of SDNY, who took over the SEC case under direction from the Second Circuit, entered a final consent judgment, permanently enjoining Armstrong from violating Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77r(a), and Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b) and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5. Armstrong settled the SEC case without admitting or denying the allegations in the SEC complaint. JA(Final Judgment, p. 2; and Consent, p. 5, ¶ 2). As is the practice of the SEC, Armstrong was required to consent to the district court's jurisdiction over him and to the subject matter of the action. JA(Final Judgment, p. 1; Consent, p. 5 ¶1).

C. Summary Administrative Adjudication by SEC

On August 6, 2008, based on the seven year contempt, the guilty plea, and the SEC settlement, the SEC staff commenced a public administrative proceedings

against Armstrong to bar him from acting as an investment adviser. JA(OIP). Even though Armstrong was still incarcerated, the SEC staff promptly moved for summary adjudication. When Armstrong asked for discovery of the SEC files, he was met instead with an argument that he did not need any discovery because a bar order could be based on the guilty plea alone. Armstrong submitted a request for an extension of time, which was denied.[29] Ultimately, no hearing was ever held.

1. Initial Decision of SEC Administrative Law Judge

The ALJ issued his initial decision on February 25, 2009. The ALJ based his findings on the indictment, the SEC complaint, and the contempt proceedings against Armstrong. Even though Armstrong consented to final judgment without admitting or denying the allegations in the SEC's complaint, the ALJ stated that they "are immune from attack." JA(Int Dec., p. 3). The ALJ also stated that, even if Armstrong's answer and response to the administrative proceeding raised constitutional challenges, his collateral attack provided no basis to deny the SEC staff's motion for summary disposition. Accordingly, the ALJ rejected Armstrong's arguments that the SEC lacked jurisdiction over the Princeton notes and rejected Armstrong's argument that his guilty plea and the SEC consent judgment were obtained in violation of his due process rights.

[29] JA(MA letter 12/8/08 to ALJ Mahoney) .

As discussed below, the ALJ's findings and conclusions are not supported by substantial evidence and are faulty in many respects. Crucial facts have been misstated or misconstrued. To the extent the ALJ based his findings on the criminal indictment rather than the allocution, he was in error. Selected paragraphs from the indictment on which the SEC staff based its motion for summary adjudication, if not supported by the allocution, cannot be a basis for the ALJ's findings. Moreover, the ALJ wrongly found that Armstrong (not Cresvale-Tokyo) sold notes to investors, and failed to point out that the so-called investors were Japanese companies. Further, the allocution, which discussed *commodities* trading, cannot be a basis for the ALJ's findings of *securities* fraud.

2. The Commission's Opinion and Order

From prison, Armstrong appealed the ALJ's initial decision to the Commission. [30] The Commission based its decision both on the criminal allocution and the guilty plea and on the final judgment by consent in the SEC civil action. JA(Comm'n Op. p. 2).

The Commission reviewed Armstrong' allocution. The Commission's opinion correctly recited that Armstrong, *through his agents*, represented that the proceeds of the accounts would remain segregated and not available to Republic for its own use. But, the Commission failed to understand the nature of the

[30] JA(Armstrong Brief).

segregation required, MA Declar ¶ 34, and conveniently dropped that part of the allocution which stated that the agents were *in Japan*. JA(Alloc, p. 20). Moreover, the Commission changed the to say that *Armstrong* failed to disclose to investors that funds in their accounts had been used to pay for losses in the trading accounts, when in fact he said that *people who worked in his office* failed to do that. *Compare* JA(Commission Op. p. 3) *with* JA(Alloc. p. 21). Nor did the Commission take into account that these people were in Japan. The Commission also ignored the fact that the allocution talked about *commodities* trading, instruments outside the SEC's jurisdiction.

The Commission upheld the initial decision of the ALJ, even though Armstrong had challenged the lack of authority to assert extraterritorial jurisdiction over such conduct. The Commission simply stated that "[w]e have repeatedly held that a party may not collaterally attack the factual allegations in an injunctive complaint …when, as is the case here, the party has consented to the entry of an injunction on the basis of such allegations."[31] The Commission ignored the fact that PEI, PGM and the SPV entities were all based in the Turks & Caicos, and failed to acknowledge that Cresvale-Tokyo, the entity that marketed the notes and handled the accounts of the Japanese companies, was beyond its territorial reach.

[31] The Commission simply referenced *17 C.F.R. § 202.5(e)*(its policy against permitting defendants to consent to judgment while denying the allegations in the complaint) and cited as authority its own decisions. JA(Comm'n Op., p. 5, notes 8 and 10).

From prison, Armstrong filed a notice of appeal to this court. In the meantime, the Supreme Court issued its opinion in the *Morrison* case.

SUMMARY OF ARGUMENT

Petitioner contends that, as a procedural matter, the SEC's complaint and companion administrative proceedings fail to state a claim for relief in light of *Morrison*. Since virtually all of Petitioner's conduct occurred in Japan, this case is almost entirely foreign in nature. The federal securities laws simply do not extend that far. In addition, it was a violation of Petitioner's due process rights to deny him counsel in the contempt proceedings and the parallel criminal case by invoking the equitable powers of the court to override civil asset forfeiture proceedings that had been undertaken by the DOJ as part of its antecedent criminal proceedings. Further, it was a denial of due process to continue to utilize civil contempt to seek additional criminal restitution. Finally, it was a violation of Petitioner's due process rights to use civil contempt to extract a guilty plea.

As a substantive matter, Petitioner also contends that the notes were not securities under the Securities Act of 1933 or the Exchange Act of 1934, and he was not an investment adviser under the Investment Advisers Act of 1940. Section 30(b) of the Exchange Act also would block the application of those statutes to this case. Further, where the underlying conduct is not criminal in nature, a charge of *conspiracy*, as well as a guilty plea on which it is predicated, cannot stand.

Finally, the Commission's analysis of need for remedial relief is faulty, since it misapplied the statutes on which such sanctions can be based, improperly relied on a restitution order for which Petitioner was to receive credit, and concluded that he should be barred because, upon release from prison, he might re-enter the securities industry when Petitioner has only dealt in commodities his entire career.

Therefore, the Commission's findings and conclusions are not supported by fact or law.

STANDARD OF REVIEW

The SEC's findings of fact and legal conclusions are reviewed under principles of administrative law. "The findings of fact are subject to a review for substantial evidence, … and the 'other conclusions may be set aside only if arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *Zacharias v. SEC*, 569 F.3rd 458 , 464 (D.C. Cir. 2009).

ARGUMENT

This petition raises both procedural and substantive claims. Both provide independent grounds on which to set aside the Commission's order.

I. PROCEDURAL ISSUES

The Court need not uphold orders of other courts that exceed the territorial reach of United States law, *Morrison,* or that are otherwise obtained in violation of

Petitioner's due process rights. *Old Wayne Mut. Life Ass'n v. McDonough*, 204 U.S. 8, 23 (1907).

A. Failure to State a Claim on Which Relief Can Be Granted

1. The Morrison Decision

In *Morrison*, the National Australia Bank ("NAB"), a foreign bank whose ordinary shares were traded on foreign exchanges, acquired a Florida corporation. NAB shareholders, who were Australians and who had purchased their shares on foreign exchanges, sued in federal district court in the United States, alleging violations of Section 10(b) of the 1934 Exchange Act, claiming that the Florida-based subsidiary had falsified financial data, which, when publicly disseminated, caused NAB's stock price to fall. Defendants moved to dismiss for lack of subject matter jurisdiction and for failure to state a claim for relief.

The district court dismissed the case on subject matters jurisdiction grounds. The Second Circuit affirmed. The Second Circuit reasoned that under that circuit's "conduct" test for assessing subject matter jurisdiction, the court lacked jurisdiction over the claims in question. The actions taken by NAB in Australia were more central to the fraud than the alleged manipulation of any financial numbers by the Florida subsidiary, there was no allegation that the fraud had any impact on America or Americans, and the chain of causation between the Florida

subsidiary's actions and the statements that reached investors was lengthy. The Supreme Court affirmed, but on grounds of failure to state a claim for relief.

The Supreme Court stated that it needed to correct a "threshold error in the Second Circuit's analysis," and held that the question presented was not one of subject matter jurisdiction, but one going to the merits. 130 S.Ct. at 2877. The Court found that the district court "had jurisdiction" under Section 27 of the Exchange Act, 15 U.S.C. §78aa. *Id*.

However, the Court reiterated the "longstanding principle of American law that 'legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'" 130 S. Ct. at 2877. This principle represents a canon of construction and "rests on the perception that Congress ordinarily legislates with respect to domestic, not foreign, matters." *Id.* [32] After reviewing the Exchange Act's legislative history, the Court found "no affirmative indication that … § 10(b) applies extraterritorially, and we therefore conclude that it does not." *Id.* at 2883.

The Supreme Court thus put to rest a long line of cases decided by the Second Circuit that had "excised the presumption against extraterritoriality from the jurisprudence of § 10(b)…." *Id. at 2879*. The Supreme Court rejected the

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[32] The Supreme Court placed its primary reliance on a 1987 decision issued by this circuit court in *Zoelsch v. Arthur Anderson & Co*., 824 F.2d 262 (D.C. Cir. 1987).

"conduct" test because "we think that the focus of the Exchange Act is not upon the place where the *deception* originated, but upon *purchases and sales of securities* in the United States. " *Id.* at 2884 (emphasis added). The Court reasoned that Section 10(b) does not punish deceptive conduct, but only deceptive conduct "in connection with the purchase or sale of a security on a national securities exchange in the United States." *Id.* Thus, the Supreme Court held that "it is … only transactions in securities listed on domestic exchanges and domestic transactions in other securities, to which § 10(b) applies." *Id.* at 2884.

The Supreme Court also threw out the "effects" test, pursuant to which the district courts could assert subject matter jurisdiction when the conduct in question had some substantial effect in the United States or upon United States citizens. Again, the issue is not whether the defendant's conduct had some effect – be it substantial or otherwise – in the United States, but whether there were *transactions* in domestic securities on domestic exchanges in the United States.

Importantly, the Court noted that some domestic aspect of a case will not be enough to create a valid claim for relief. "For it is a rare case of prohibited extraterritorial application that lacks *all* contact with the territory of the United States. But the presumption against extraterritorial application would be a craven watchdog indeed if it retreated to its kennel whenever *some* domestic activity is involved in the case." *Id.* at 2884 (emphasis in original). Thus, many essentially

foreign transactions will inevitably have some domestic aspect to them, but will be insufficient to support a claim for relief .[33]

Such is the case here, which is almost entirely a foreign one. The notes were marketed in Japan by a Japanese brokerage house to Japanese corporations. The notes were also issued by PGM, a Turks & Caicos company. Even if there may have been a few commodities futures trades on the CME, or a few telephone calls within the United States, such conduct does not provide a basis to assert a claim for

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[33] In response to the Supreme Court's ruling in *Morrison*, Congress added a last minute provision to the Dodd-Frank Act to restore the extraterritorial jurisdictional reach of the SEC and of the DOJ through a new formulation of the conduct and effects tests. Section 929P of Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 confers U.S. court jurisdiction over violations of those the anti-fraud provisions of the securities laws for (i) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors, or (ii) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.*, H.R. 4173, 111th Congress (2009-10).*

Section 929P, however, lacks retroactive effect. The change is not merely procedural, but substantive because it would restore and validate for the SEC and the DOJ claims and criminal charges that *Morrison* would not uphold. See e.g., *In re John Lawton, SEC Admin. Proc. No. 3-14162, at 4-5* (Apr. 29. 2011), in which the chief administrative law judge at the SEC recently declined to apply the new Dodd Frank collateral bar order provisions in the SEC's case against a hedge fund manager who pled guilty, because the new provision of Dodd Frank adding new sanctions attached new legal consequences and was therefore "impermissibly retroactive."

relief under the federal securities laws. Accordingly, neither the SEC complaint, nor the criminal indictment would have survived a *Morrison* analysis.

2. The SEC Suit and Settlement

The SEC sponsored consent settlement based on its underlying complaint suffers from the same infirmity. The allegations in the SEC's complaint seek to reach extraterritorial conduct. The SEC's complaint would have found resistance in the decisions of several circuits, including this one, that implicate the Due Process Clause. *Zoelsch*, at 29. [34] In light of *Morrison* and *Zoelsch*, the SEC cannot continue to rely on that complaint for further law enforcement purposes.

3. The Administrative Decisions Below

Disregarding the foreign nature of this case, the Commission was impressed by *allegations* in the SEC complaint that Armstrong owned PEI and *controlled* all of the Princeton subsidiaries, including the SPVs, which issued the Princeton notes. Even though these allegations are not factually correct, MA Declar. ¶¶ 1-3, the Commission's finding of a permissible extraterritorial application of the securities laws based on "control" by Armstrong over entities in Japan and the Turks & Caicos is faulty. The notion of "control" cannot overcome the presumption against extraterritoriality expressed by this court in *Zoelsch* and by the

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[34] If the SEC had brought the case in the DC Circuit, which they are permitted by statute to do, they would have been confronted with this court's decision in *Zoelsch* and the complaint would have been dismissed.

Supreme Court in *Morrison.* Similarly, any allegation that Armstrong may have "directed" trading in the accounts in Japan and or may have "caused" certain NAV letters to be sent by Republic to PGM fail to pass muster under *Morrison*. If there has been no purchase or sale of a domestic security on a recognized exchange in the United States, the complaint fails to state a claim on which relief can be granted and the companion administrative proceedings based on that complaint must fall as well.

B. Improper Summary Adjudication Based on Contempt Proceedings and Guilty Plea

The SEC staff relied heavily on the contempt proceedings and the guilty plea in its motion for summary adjudication. Armstrong wrote extensively about both in his response.[35] The ALJ relied on both the contempt and the guilty plea, and the ALJ and the Commission placed heavy reliance on the guilty plea in making their findings of fact and need for remedial relief. Both, however, are replete with due process violations.

1. Improper Use of Parallel Proceedings

a. Use of Seizure Warrant and Asset Freeze

Once the DOJ's case was commenced with a seizure warrant on September 2, 1999, the district court had jurisdiction *in rem* over the bank accounts of PGM, jurisdiction which could not be divested by initiation of a later SEC suit in equity

[35] JA(Armstrong Letter & Response).

and the appointment of a receiver. *Lion Bonding & Sur. Co. v. Karatz,* 262 U.S. 77, 88-89 (1923); *see also Republic Nat'l Bank v. United States*, 506 U.S. 80, 93 (1992). Judge Owen could not thereafter assert *in personam* jurisdiction over the same *in rem* assets, purportedly through the SEC's injunctive case relying on his equitable jurisdiction and ancillary powers to issue an asset freeze.[36] The bank accounts were the subject of the DOJ's antecedent criminal proceedings, commenced by obtaining a seizure warrant in advance of filing the criminal complaint. The DOJ had control of the assets *in rem* through that warrant, which it maintained in force until January 2004, when the USAO filed an application, following the Republic guilty plea, to have the warrant vacated so that the Receiver could make an interim distribution to the so-called victims. JA(*Vacatur* Order).

It was also an improper for the SEC to seek and fore the district court to impose an asset freeze over those same bank accounts when the accounts represented funds from *unsecured* notes. *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund*, 527 U.S. 308 (1999) ("the equitable powers conferred by the Judiciary Act of 1789 did not include the power to create remedies previously unknown to equity jurisprudence. Even when sitting as a court in equity, we have

[36] The issuance of an asset freeze is merely ancillary to the court's equitable powers under Section 21 (d)(1) of the Exchange Act, 15 U.S.C. 78u(d)(1). *See e.g., SEC v. Unifund SAL*, 910 F.2d 1028, 041(2d Cir. 1990).

no authority to craft a 'nuclear weapon' of the law like the one advocated here [i.e., asset freeze over unsecured notes]."). *See also Lion Bonding, supra.*

b. Denial of Counsel

After obtaining the asset freeze, the government early on sought to deprive Armstrong of his counsel in the parallel proceedings in deprivation of his due process rights.

(i) Denial of Counsel of Choice in Criminal Case

On August 29, 1999, prior to the seizure warrant, Armstrong paid a sizeable retainer to his lead attorney, Richard Altman, who employed other counsel in the parallel civil and criminal cases. After the asset freeze was issued, Armstrong's counsel of choice were required by April 2000 to return the retainer in the SEC case and withdrew. Thus, it was the court sitting in equity that took away Armstrong's lead attorney and his counsel of choice in the parallel criminal case. This was an improper exercise the court's equitable powers and was a structural error and denial of due process. *United States v. Gonzalez–Lopez,* 548 U.S. 140, 126 S.Ct. 2557, 165 L.Ed.2d 409 (2006) (no showing of prejudice and reversal of the conviction required).

Attempting to invoke the protections of the Civil Asset Forfeiture Act, 18 U.S.C. §981, *et seq.,* Armstrong twice raised the issue of civil forfeiture, once *pro se* in the SEC civil case JA(Tr. 10/3/00, p. 52) and again in the criminal case

JA(Tr. 8/20/02, p. 6-16). Both times he was told by the court that this was not a case of civil forfeiture. Both times, the government attorneys sat quietly and failed to remind or apprise the court of the outstanding seizure warrant. [37]

By sitting quiet, Armstrong was not only deprived of his rights as an indicted person to obtain discovery or even a stay of the forfeiture proceedings, 18 U.S.C. §981(g), more importantly he was also deprived of his right to pursue a *Monsanto* hearing to restore his former counsel – a hearing that Judge McKenna had previously authorized in the criminal case, but which he then denied. JA(Tr. 8/20/02, p. 5-8).[38] Had the government spoken up and such a hearing been held, Armstrong could have proven that the bank accounts related to his proprietary trading only, not to note holder funds. [39]

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[37] It is no answer to say that his previous attorneys might have known about it and its possible implications. Once the issue was raised by Armstrong, the government attorneys had a duty to inform the court.

[38] In *United States v. Monsanto,* 491 U.S. 600 (1989), the Supreme Court stated that there would be no constitutional violation only "when, after probable cause is adequately established," the attorney fees are traceable to criminal conduct. 491 U.S. at 616.

[39] The contents of the Republic bank account from Armstrong's proprietary trading included at least (1) $14 million profits made on the Maruzen fixed rate note from foreign exchange trading, (2) the differential earned on FNMAs at 8 percent and the fixed rate note payment of 4 percent, and (3) profits made from hedging futures contracts for the earlier $2 billion in notes. There were also profits from the other foreign offices of Princeton.

(ii) Denial of Counsel in SEC Case

At the outset, SEC counsel stated that "[w]e want the assets to be frozen with … no money for attorney's fees." JA(Tr: 9/13/99; p. 24-25). Since it was improper to issue the asset freeze, it was a denial of due process to require Armstrong's lawyers to return the funds and withdraw from the SEC case.

(iii) Denial of Counsel During Initial Stages of Civil Contempt

On January 20, 2000, after a hearing initiated by the Receiver, Armstrong was taken into custody and incarcerated at the MCC. Since his lawyers in the SEC case were forced to withdraw, Armstrong was left without counsel in the civil contempt for almost one year until the Second Circuit appointed *appellate* counsel to prosecute petitioner's appeal of the contempt.

The denial of counsel to Petitioner for almost one year in the civil contempt while incarcerated was a violation of the Due Process Clause. *Turner v. Rogers*, --S.Ct. ---, 79 USLW 4553, at 9 (June 20, 2011)(right to counsel in contempt cases involving incarceration.). This was particularly egregious given the parallel criminal indictment he was facing:

> The 'private interest that will be affected' argues strongly for the right to counsel that Turner advocates. That interest consists of an indigent defendant's loss of personal liberty through imprisonment. The interest in securing that freedom, the freedom 'from bodily restraint,' lies 'at the core of the liberty protected by the Due Process Clause.' [citation omitted.] And we have made clear that its threatened loss through legal proceedings demands 'due process protection.'

Turner, 79 USLA at 10.

2. Additional Uses of Civil Contempt in Violation of Due Process

a. Use of Civil Contempt to Extract Additional Criminal Restitution

Republic pled guilty to allegations for the time period between *1995 through September 1999* and paid restitution in an amount that, according to the government, made all of the victims whole. In a moment of utter candor, however, the USAO for the SDNY stated in open court that the real reason for the *civil* contempt of Armstrong was the government's belief that there was additional money available for *criminal* restitution:

> AUSA ALEXANDER SOUTHWELL: So to be clear, in the event of a conviction, [the USAO] will request, your Honor, that there be an order of contribution reimbursing ultimately HSBC, who basically made good and paid out these losses for whatever reasons that they did. They compensated the victims ... We frankly think that there is money available, which is part of the reason why Mr. Armstrong has been held in civil contempt …

JA(Tr; 6/24/05, p.11-12).

To prolong the civil contempt for this reason was an abuse of prosecutorial power and a violation of Petitioner's due process rights. The criminal authorities cannot utilize the civil side of the court in a parallel criminal proceedings to exact further criminal restitution or to additional acquire assets. *See U.S. v. Razmilovic*, 419 F.3d 134 (2d Cir. 2005). Such abuse of parallel proceedings has not passed constitutional muster in other contexts. *SEC v. Healthsouth*, 261 F. Supp. 2d 1298,

1312 n. 23 and 1326 (N.D. Ala. 2003)("where the government has undoubtedly manipulated simultaneous criminal and civil proceedings, both of which it controls, 'there is a special danger that the government can effectively undermine rights that would exist in a criminal investigation by conducting a de facto criminal investigation using nominally civil means. In that special situation the risk to individuals' constitutional rights is arguably magnified.")

It was also a violation of Armstrong's due process rights constructively to amend the SEC complaint to include a time period earlier than alleged as a basis to support an ongoing civil contempt. In January 2002, the Receiver told the district court that there was *another fraud* prior to the Republic time period (i.e., 1995 to September 1999), presumably referring to the time period when Armstrong had a relationship with Prudential before the accounts were moved to Republic. Yet, the Receiver admitted that there were *no allegations* of criminal liability during that time period: "Losses that occurred in the [P]rudential period [1992-1995] … are not embraced within the restitution by HSBC … and in the period before the false NA[V letters,] there is no … description of criminal liability. " JA(Tr: 1/7/02, p. 17) .

Of course, the same is true of the SEC complaint. There were never any allegations of fraudulent conduct prior to 1996. JA(SEC Cmplnt ¶¶ 1, 12). There could be no false NAV letters prior to 1998, the date Republic's own internal

auditors indicated that there were still profits. MA Declar ¶¶ 20, 21, 23; JA(M Hershey Ltr). Thus, the Receiver's "constructive amendment" to the SEC complaint, purportedly based on commingling and false NAV letters for *commodities* trades, though not based on fact, MA Declar ¶ 36, failed to provide adequate notice of charges required by due process. *World-Wide Volkswagen Corp v. Woodson*, 444 U.S. 286, 291 (1980). Worse, this so-called amendment to the SEC complaint continued to be used by the government attorneys to support their claim of continued need for civil contempt in the hopes of uncovering more money.

b. Use of Civil Contempt to Force a Guilty Plea

The government also continued to use the coercive powers of civil contempt to extract a *criminal plea* from Armstrong. The government placed Armstrong in the "hole" in August 2006, JA(Bloomberg), and informed him that if he refused to plead guilty and intended to go to trial, he would go to trial from the hole. MA Declar ¶¶ 49- 52. After seven days in the hole, the government brought him up and informed him that if he did not take a plea bargain, he would go back into the hole, would be prosecuted and could be jailed for 135 years. *Id.* In fear of loss of liberty for life and having been stripped of his preparation materials, Armstrong responded that if he accepted the plea agreement, he wanted to request credit for time served in civil contempt. The prosecutors agreed. *Id.* ¶ 51.

As a general rule, a “defendant’s knowing and intelligent guilty plea forecloses ‘independent claims relating to the deprivation of constitutional rights that occurred prior to the entry of the guilty plea, ’ ” *Tollett v. Henderson*, 411 U.S. 258 (1973); *Brady v. U.S.* 397 U.S. 742 (1970), when the plea is entered “with sufficient awareness of the relevant circumstances and likely consequences.” ” *Bradshaw v. Stumpf,* 545 U.S. 175, 183 (2005). *Accord United States v. Drew,* 200 F.3d 871, 876 (D.C.Cir.2000). However, the guilty plea must not be “compelled” within the meaning of the Due Process Clause of the Fifth Amendment. Thus, the guilty plea must be “‘ free and voluntary: that is, [it] must not be extracted by any sort of threats or violence, nor obtained by any direct or implied promises, however slight, nor by the exertion of any improper influence.”’ *Brady*, 397 U.S. at 752.

One exception to this general rules is the defendant's claimed right “not to be haled into court at all,” such as one where the charged offense violates the double jeopardy clause, *Blackledge v. Perry,* 417 U.S. 21, 30-31 (1974); or, one where the state may not constitutionally prosecute, *Menna v. New York,* 423 U.S. 61, 62-63 & n. 2 (1975) (*per curiam*).

The Supreme Court in *Blackledge* was concerned with vindictiveness towards criminal defendants:

> “The lesson that emerges from [those cases] is that the Due Process Clause is not offended by all possibilities of increased punishment

> upon retrial after appeal, but only by those that pose *a realistic likelihood of 'vindictiveness*.' Unlike the circumstances presented by those cases, however, in the situation here the central figure is not the judge or the jury, but the *prosecutor*. The question is whether the opportunities for vindictiveness in this situation are such as to impel the conclusion that due process of law requires a rule analogous to that of the Pearce case. We conclude that the answer must be in the affirmative."

417 U. S.Ct. at 27 (*emphasis added*). The Court pointed out that the prosecutor has a considerable stake and motivation in discouraging defendants from exercising their rights. If the prosecutor has the means to discourage defendants from exercising their rights by "upping the ante, " only the most hardy defendant will brave the hazards. *Id.*

The same concerns are present here. If Armstrong did not plead guilty as demanded, the federal prosecutors would simply have "upped the ante" by throwing him back into the hole, improperly using the unfettered civil contempt until they had extracted a guilty plea from him, and by using the leverage of a threatened 135 years in jail.

Here, as in *Blackledge*, other than Armstrong's declaration, there is no record of vindictiveness by the federal prosecutors in the SDNY, and they closely guarded the scripted record at the allocution to protect themselves. But, the lack of such evidence does not block the application of the Due Process Clause. The Supreme Court held in *Blackledge* that it is the *fear of retaliation*, not the evidence of it, that the Due Process Clause protects:

> There is, of course, no evidence that the prosecutor in this case acted in bad faith or maliciously in seeking a felony indictment against Perry. The rationale of our judgment in the Pearce case, however, was not grounded upon the proposition that actual retaliatory motivation must inevitably exist. Rather, we emphasized that 'since the fear of such vindictiveness may unconstitutionally deter a defendant's exercise of the right to appeal or collaterally attack his first conviction, due process also requires that a defendant be freed of apprehension of such a retaliatory motivation on the part of the sentencing judge.' 395 U.S., at 725, 89 S.Ct. at 2080. We think it clear that the same considerations apply here. A person convicted of an offense is entitled to pursue his statutory right to a trial de novo, without apprehension that the State will retaliate by substituting a more serious charge for the original one, *****2103*** thus subjecting him to a significantly increased potential period of incarceration.

417 U.S. at 28. Just as it was a violation of due process in *Blackledge* by upping the ante to a more serious charge and more jail time, it was a violation of the prosecutors in this case to prolong the civil contempt, threaten to throw Armstrong back into the hole, and threaten him with added criminal charges and with incarceration beyond his life time if he refused to plea guilty and insisted on going to trial.

II. SUBSTANTIVE ISSUES

It is axiomatic that this court may inquire into the jurisdictional bases of all prior proceedings on which the SEC relies. *Old Wayne Mut. Life Ass'n,* 201 U.S. at 16-17 (1907)("the jurisdiction of any court exercising authority over a subject 'may be inquired into in every other court when the proceedings in the former are

relied upon and brought before the latter by a party claiming the benefit of such proceedings,'…")

A. ABSENCE OF SUBJECT MATTER JURISDICTION

1. The Princeton Notes Were Not "Securities" Subject to Regulation By the SEC

The district court, the SEC and the DOJ assumed, without analysis, that the Princeton notes were "securities," *SEC v. Princeton Econ. Int'l,* 73 F. Supp. 2d 420, 423 (S.D.N.Y. 1999). This has been error from the beginning.

The fixed rate notes were not securities. A straight loan of money for a 4 percent interest payments is not a security. The variable rate notes do not readily admit of analysis under the *Reves'* family resemblance test. *Reves v. Ersnt & Yong*, 494 U.S. 56, 63-65 (1990). Instead, the Princeton notes more closely resemble swap contracts.[40] Unlike credit default swaps, which can be deemed a "security" when security-based*, see e.g., SEC v. Rorech,* 720 F. Supp. 2d 367 (S.D.N.Y. 2010), "plain vanilla" interest rate swaps are not. *K3C, Inc v. Bank of America,* 204 Fed. Appx. 455 (5th Cir. 2006). *See also St. Matthew's Baptist Church v. Wachovia Bank Nat'l Ass'n,* 2005 WL 1199045 (D. N.J. 2009). The Princeton variable rate notes closely resemble "plain vanila" interest rate swaps. The basket

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[40] An interest rate swap agreement is a contractual arrangement that sets a maximum interest rate that a borrower is required to pay on a loan. The parties agree to exchange interest payments on specific dates on a defined principal amount for a fixed period of time, according to a predetermined formula.

of stocks served as the notional amount, which was not exchanged, and PEI promised to pay a fixed or variable rate of interest. The return on the Princeton notes was not tied to any underlying securities.

Moreover, as the Supreme Court stated in *Reves*: " Congress was concerned with regulating the investment market, not with creating a general federal cause of action for fraud." *Id.* Congress certainly could not have been concerned with regulating a market in *Japan.* This is especially true of sophisticated "investors," who can fend for themselves and do not need the protection of the securities laws. *Teherepnin v. Knight*, 389 U.S. 332, 335 (1967)(" the definition of security in §3(a)10) necessarily determines the classes of investments and investors which will receive the Act's protections.)

Even though the term "note" appears in the statute defining a "security," [41] when an instrument resembling a security is issued by a foreign financial institution which is well regulated, those instruments will not be deemed securities for purposes of the federal securities laws. *See e.g.*, *Wolf v. Banco Nacional de Mexico, S.A.*, 739 F.2d 1458 (9th Cir. 1984) (Mexican bank' s sale of certificates of deposit into the United States were not securities when bank is sufficiently well regulated and repayment was virtually guaranteed, the court unimpressed with

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[41] Section 2(1) of the Securities Act, 15 U.S.C. §77b(1), and §3(a)(10) of the Exchange Act, 15 U.S.C. §78c(a)(10), both state that the term "security" includes "any note…."

concerns over exchange rate risk involved.) [42] *See also Fidenas AG v. Compagnie Internat'l,* 606 F.2d 5, 9 (2d Cir. 1979)(note transactions were "predominantly foreign").

This case involves the marketing and issuance of unsecured promissory notes to Japanese companies in Japan by PEI, a Turks & Caicos company, through Cresvale-Tokyo. The notes were negotiated at arm's length by sophisticated parties. [43] There was no solicitation of Japanese companies within the United

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[42] The court in *Wolf* dismissed as insignificant the same exchange rate risk that caused the government concern in this case:

> A resident of Germany who, in 1970, used deutsche marks to purchase through the mail a certificate of deposit of dollars from Marine Bank would have suffered the same type of loss, when the bank repaid him after the devaluations of the dollar in 1971 and 1973, as Wolf alleges here. The federal regulations and deposit insurance that were so important to the Court in *Weaver* would not in any way have protected this hypothetical depositor from losses caused by the devaluation. Whether a bank's certificate of deposit is a security surely cannot turn on the currency with which it is purchased or in which it is payable. The devaluation risk present whenever a certificate of deposit is purchased with or payable in a foreign currency therefore does not distinguish the certificates that Wolf bought from [the Mexican bank] that which the Weavers bought [from a US bank].

739 F.2d at 1462.

[43] As the Supreme Court stated in *Sandberg v. McDonald,* 248 U.S. 185, 195-96 (1918):

> Legislation is presumptively territorial … .* * * Congress could not prevent the making of such contracts in other jurisdictions. If they saw fit to do so, foreign countries would continue to permit such contracts and advance payments no matter what our declared law or policy in regard to them might be … .

States. These notes were not signed in the United States and were never issued to United States investors. The JMOF pre-approved the issuance of these notes to the Japanese companies. Most were issued in nominee name to Cresvale –Tokyo, which means they existed only internally on the books of Cresvale and were not publicly traded. As a registered broker-dealer, Cresvale-Tokyo was well regulated by the Japanese FSA and was routinely examined. Cresvale also paid $5 million into the Japanese Investor Protection Fund, a body much like SIPC in the United States, to provide a source of funds to customers in the event of losses. Accordingly, there was no need for the SEC to interject itself into this case.

2. Armstrong Was Not an Investment Advisor

Armstrong never allocuted to any notion that he, PEI or PGM was an investment adviser. Although the SEC's complaint alleged that *PEI* acted as an investment adviser to the PGM SPVs, which issued the notes, JA(SEC Cmplt ¶ 14), in the SEC's motion for summary disposition before the ALJ, the staff argued that *Armstrong* was the investment adviser. JA(SEC Mot, at 12). The ALJ concluded that *Armstrong* was an investment adviser JA(ID, at 5), whereas the Commission itself decided that it was *PEI* that was the adviser without identifying who it was that PEI advised. Under such a confused and inconsistent record, the SEC is not entitled to any deference. *See EEOC v. Arabian Oil*, 499 U.S .244, 257 (1991); *Morrison*, 130 S.Ct. at 2888.

Neither Armstrong nor PEI was an investment advisor within the meaning of the securities laws.[44] Armstrong was not engaged in the business of advising others as to the value of certain securities, nor as to the advisability of purchasing, selling or otherwise investing in certain securities. He simply swapped yen for US dollar interest rate and exchange rate risk. Moreover, he engaged in the proprietary trading of *commodities* futures contracts, not securities.[45]

Even if the actions of Armstrong or PEI somehow qualified one or both of them him as investment advisers,[46] the conduct at issue took place in Japan and with Japanese companies. There was no advisory contract or services provided in the United States. And, to the extent any stocks were sold from the portfolios of the Japanese companies, they were all Japanese stocks traded on the Tokyo stock exchange and thus transactions beyond the reach of the US securities laws. *Morrison, supra.*

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[44] JA(IA § 202(a)(11).

[45] In November 1996, the New York Mercantile Exchange, after concluding its audit of Republic Securities' back office operations in New York City, was advised by Republic personnel that the structure of the accounts was proprietary and did not require registration with the SEC or CFTC. JA(NYMEX Lr, 11/6/96).

[46] The SEC staff's moving papers for summary disposition are devoid of any argument or analysis as to why either PEI or Armstrong qualified as investment advisers. JA(SEC Mot, p. 12).

Since the government invoked the anti-fraud provisions of the Exchange Act, Section 30(b) of the 1934 Exchange Act also would seem to have stopped both the SEC civil and the DOJ criminal cases from going forward. Section 30(b) states that the Exchange Act "shall not apply to any person insofar as he transacts a business in securities *without the jurisdiction of the United States,* unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter." Section 30(b) is not self executing. 15 U.S.C. Sec.§ 78dd(b) (1982) [Appendix]. It requires the SEC to have adopted regulations under that section, but the SEC has failed to do so. *See also Zoelch v. Arthur Anderson & Co*., 824 F.2d 262, 305 (D.C. Cir. 1987)(§30(b) does not apply where there is no allegation that defendant's conduct was designed to evade American law.)

B. ABSENCE OF EXTRATERRITORIAL JURISDICTION UNDERLYING CRIMINAL CHARGES

Armstrong only pled to a *conspiracy*, not the underlying substantive offenses.[47] Given the foreign nature of the transactions and conduct and the

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[47] Since neither the ALJ nor the SEC itself relied on those provisions of Section 203(f) relating to *commodities* fraud, that issue is not addressed. In any event, the Japanese companies were not the person "for or on behalf of" whom Armstrong entered into the commodities trading contracts. *See e.g., Tatum v. Smith, 887 F.Supp. 918, 921-22 (N.D. Miss. 1995), aff'd sub nom. Tatum v. Legg Mason Wood Walker, Inc.*, 83 F.3d 121 (5th Cir. 1996).

prescription of §30(b), the DOJ could not in good faith have pressed the charges as vigorously as it did. A charge of conspiracy cannot cure the underlying infirmity.

1. No Underlying Crime of Securities Fraud

If someone could no longer be charged with the underlying offense after *Morrison*, they could not have *conspired* to commit it in violation of 18 U.S.C.§371. [48] *See e.g., American Banana Company v. United Fruit Co.*, 213 U.S. 347, 357 (1909)("A conspiracy in this country to do acts in another jurisdiction does not draw to itself those acts and make them unlawful, if they are permitted by the local law.")

As a result of *Morrison*, count one of the indictment would be a legally insufficient basis on which to convict, see *Yates v. United States,* 354 U.S. 298 *(1957), see also Griffin v. United States,* 502 U.S. 46, 58-59 (1991*),* and accordingly would be legally insufficient to support a guilty plea. The federal securities laws do not reach outside the United States to conduct that is almost exclusively, if not predominantly, foreign. *Fidenas AG, supra.* The fact that Armstrong admitted in his allocution that an "exchange is in Manhattan" is legally insufficient. The mere existence of a commodities exchange in New York, without some evidence of transactions on that exchange in furtherance of fraud and the

[48] [18 U.S.C. § 371]

conspiracy,[49] is legally insufficient, as is the existence of a few telephone calls in the United States. *Morrison*, 130 S. Ct. at 2884.

Nor can a plea to securities fraud be based on the NAV letters. Those letters standing alone do not have any independent legal significance and by themselves do not implicate any illegal conduct under the federal securities laws. Many of the early letters were sent to PGM in the Turks & Caicos merely to confirm receipt at Republic of money wired by Cresvale-Tokyo from Japanese banks, wires that had been preapproved by the JMOF. The ALJ misconstrued these letters as "false account statements," which they were not. [JA(Int. Dec p. 3). The *account statements* were sent by Cresvale-Tokyo to the Japanese companies in Japan. By contrast, the *NAV letters* were not sent to the Japanese companies in the ordinary course of business.

The NAV letters do not even relate to Armstrong's proprietary trading in commodities. The NAV letter only showed total account value, not trading, and the cash provided by the note holders remained in the PGM accounts. The proprietary trading by PEI was done with a credit line extended by Republic Bank, unrelated to the note holders' monies. To the extent that the NAV letters are inaccurate, it could be attributable to fraudulent trading by Republic officials, MA

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[49] There has been nothing to suggest that the few mental contracts traded on the Comex had anything to do with the note holder accounts, which is not surprising, given that they were for hedging purposes.

Declar ¶¶ 25-26, especially since Armstrong was not monitoring those accounts. Id. ¶26.

In the allocution, Armstrong was required to admit that he falsely represented to investors that his trading performance in *commodities* was better than it was, and he admitted he had deceived investors "in connection with trading of *commodities* investments." JA(Alloc. p. 22). It was error for the ALJ and the Commission to base its bar order on conduct involving *commodities* trading, and it was error for the ALJ and the Commission to base their findings on commodities *trading* that had nothing to do with the note holders.

Accordingly, there is no substantial evidence in the record to support the ALJ's and SEC's findings.

2. Conspiracy to Commit Wire Fraud Related to Proprietary Trading

Many of the wire frauds alleged in the superseding indictment concern transactions in Japan and wire transfers sent from Japanese banks to Republic JA(SI, ¶ 75), presumably when Cresvale -Tokyo requested the Bank of Tokyo to convert Japanese yen to US dollars and wire those funds to Republic with approval of the JMOF.[50]

Despite the allegations in the indictment, however, the *allocution* governs what conduct Armstrong admitted to and what conduct can be the basis for a

[50] There are no allegations in the SEC complaint concerning use of the wires.

"finding" by the ALJ and the SEC. The only possible reference to wire transfers in the allocution is to Republic's taking of the monies in August 1999 to cover the disputed deficit in the eight proprietary trading accounts. Armstrong never requested, nor approved the taking of those funds by Republic. And, *failure* to inform the note holders is not wire fraud. Moreover, when Republic merged the accounts, these transfers were not wire transfers in interstate or foreign commerce, but rather *internal book keeping entries* within Republic Bank itself.

Further, any telephone conversations with Republic about the disputed deficit in Armstrong's proprietary trading accounts were not *material* to the scheme, especially when Armstrong confronted Republic officials about what was happening in the accounts and threatened suit against Republic for its taking of the excess funds. In *Neder v. United States*, the Court stated that an element of the wire fraud statute is a finding that the alleged misrepresentation regarding the scheme was material. 527 U.S.1, 20- 25 (1999). Here, there was no finding that Armstrong's telephone calls were material to any scheme to defraud the note holders, since they more likely than not related to proprietary hedging transactions, unrelated to any alleged scheme.

Therefore, to the extent that the ALJ's and The SEC's findings were based on conspiracy to commit wire fraud, they lacked substantial evidence and were legally insufficient.

C. BAR ORDER NOT APPROPRIATE

Even though there was no clear explanation either by the ALJ or the Commission why Armstrong or PEI qualified as an investment adviser, the ALJ found that an associational bar was appropriate. The Commission reached the same conclusion.

The ALJ based the imposition of a sanction on Sections 203(f) and 203(e)(2)(A) and (B) and (e)(4) of the Investment Advisers Act. The Commission was less clear, just referring to Section 203(e) and (f).

Section 203 (f) cross references section 203(e)(2) and (3). Section 203 (e)(2) authorizes sanctions if a person has been convicted of a felony (A) "involving the purchase or sale of any security" or (B)" arises out of the business of a … investment adviser." Subsection 203(e)(2)(A) is not applicable because, as explained above, this case does not involve the purchase or sale of securities and is not one that requires the protections of the United States securities laws, *Wolf v. Banco Nacional de Mexico.* In any event, the SEC cannot assert extraterritorial jurisdiction over any such conduct. *Morrison*, *supra.* [51]

Nor can sanctions be imposed under Section 203(e)(2)(B). Neither PEI, nor PGM, nor Armstrong were not engaged "in the business of an investment adviser"

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[51] Neither the ALJ nor the SEC based their findings on section 203(e)(D), which would not apply to conspiracy.

to which the SEC can assert extraterritorial jurisdiction. Although *Morrison* did not concern itself with the application of the Investment Advisers Act of 1940, the principles articulated in *Morrison* represent a canon of construction that "rests on the perception that Congress ordinarily legislates with respect to domestic, not foreign, matters." 130 S. Ct. at 2877,*Id.* [52] It therefore applies to the Advisers Act.

Both the ALJ and the SEC also based the need for sanctions on the fact that Armstrong had been enjoined, *see* Section 203(e) (4). That subsection applies to persons enjoined "from acting as an investment adviser" or "from engaging in…any conduct or practice … in connection with the purchase or sale of any security." However, the SEC final judgment did not enjoin Armstrong from acting as an investment adviser. Accordingly, there was no basis on which to make such a finding. In addition, even though the injunction applied to conduct in connection with the purchase or sale of a security, the application of subsection (e)(4) would suffer from the same infirmity as subsection (e)(2), most notably its application to foreign conduct.

Undeterred by its faulty legal analysis, however, the ALJ and the SEC applied the six "public interest" factors that must be present to satisfy the need for

[52] Cf. § 30(b) of the Exchange Act, discussed *supra*.

remedial relief.[53] The Commission relied heavily on the notion that "antifraud violations, such as those committed by Armstrong, are 'especially serious and subject to the severest sanctions.'" JA(Comm'n Op, p. 6). It also said that "[w]e have found that 'an antifraud injunction can, in the first instance, indicate the appropriateness in the public interest of . . . [a] bar from participation in the securities industry.'" *Id.* However, those pronouncements cannot pass scrutiny after *Morrison* or under Section 30(b) of the Exchange Act.

Applying the *Steadman* factors, the Commission found, with remarkable insight and clairvoyance, that there is a likelihood that Armstrong will, after his release from prison, "be able and inclined to re-enter the securities industry where he would confront opportunities to violate the law again." *Id. at 7*. Since Armstrong has only been engaged in *commodities* trading his entire life, that statement was utterly lacking in foundation. It also overlooked the fact that Armstrong only engaged in commodities business *outside* the United States.

Both the ALJ and the Commission measured the egregiousness of Armstrong's conduct on the fact that the *$80 million restitution order* " JA(ID at

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[53] The six factors, known as the *Steadman* factors, are: (1) the egregiousness of the conduct, (2) whether the violations were isolated or recurrent; (3) the degree of *scienter*; (4) the sincerity of the respondent's assurances against future violations; (5) respondent's recognition of the wrongful nature of his conduct; and (6) the likelihood that the respondent's occupation will present opportunities for future violations. *Steadman v. SEC,* 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

5), and the Commission stated that an associational bar was needed because "[u]pon his release from prison, he would be in his early sixties and must pay approximately $80 million in restitution." *Id.* However, reliance on the dollar amount of restitution was misplaced. It not only overlooks what the government had said many times: that all of the victims have been made whole; it also overlooks what Judge Keenan ordered following sentencing: that the so-called investors were not entitled to be paid twice, that Armstrong was entitled to credit for the amounts Republic and the Receiver paid over to them, and that he was impecunious. [Keenan Order.] Further, the consent settlement in the SEC civil case specifically stated that "Armstrong shall receive credit towards satisfaction of the criminal judgment… for any and all distributions made by the Receiver of [corporate] assets." Consent ¶3.]

Accordingly, the SEC's findings are not supported by substantial evidence and tis legal conclusions were "not in accordance with law." *Zacharias, supra.*

CONCLUSION

Based on the foregoing, Appellant Armstrong respectfully requests that the order of the SEC be set aside and these administrative proceedings be dismissed.

Dated: August 19, 2011

Respectfully Submitted,

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