

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF
CALIFORNIA

Securities and Exchange Commission v. Matthew J. Werthe dba HSR
Wealth Management

SEC v. Werthe · No. 23cv0815-L-DDL · Decided March 12, 2025

SUMMARY

The United States District Court for the Southern District of California granted the SEC's motion for summary adjudication as to Matthew J. Werthe's liability on claims arising from alleged cherry-picking of securities trades and false or misleading statements to investment-advisory clients. The court concluded that the SEC established the elements of claims under the federal securities laws and that Werthe failed to raise a genuine dispute of material fact. The SEC sought injunctive relief, disgorgement, and civil penalties, with those remedies left for further proceedings.

OPINION

Securities and Exchange Commission v. Werthe

PER CURIAM.

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8 UNITED STATES DISTRICT COURT

9 SOUTHERN DISTRICT OF CALIFORNIA

10 11 SECURITIES AND EXCHANGE Case No.: 23cv0815-L-DDL

COMMISSION,

12

ORDER GRANTING MOTION FOR

Plaintiff,

13 SUMMARY ADJUDICATION

v. 14 [ECF No. 26]

MATTHEW J. WERTHE dba HSR

15

WEALTH MANAGEMENT,

16 Defendant. 17

18 19 Pending before the Court in this securities fraud action is a motion for summary 20
judgment filed by Plaintiff United States Securities and Exchange Commission (“SEC”). 21 (ECF
No. 26.) Defendant Matthew J. Werthe, proceeding pro se, filed an opposition 22 (ECF No. 27)
and the SEC replied (ECF No. 28). The Court decides the matter on the 23 papers submitted
without oral argument. See Civ. L. R. 7.1(d)(1). For the reasons stated 24 below, the motion is

granted to the extent of Defendant's liability on the claims alleged in 25 the complaint. 26 / / / / /
27 28

1 I. BACKGROUND

2 In June 2019, Defendant Matthew J. Werthe started HSR Wealth Management 3 ("HSR"),² a California-registered investment adviser. Mr. Werthe was the sole owner, 4 employee, and Chief Compliance officer of HSR and was solely responsible for all its 5 day-to-day activities. He engaged in the business of providing investment advice 6 regarding equity stocks, fixed income securities, bonds, exchange traded funds ("ETFs"), 7 mutual funds, and cash equivalent instruments. His clients paid him advisory fees based 8 on a percentage of assets under management. Mr. Werthe had discretionary authority 9 over his clients' brokerage accounts to trade on their behalf without prior permission. As 10 of March 2022, he had over 50 clients and over \$12 million in assets under management. 11 Defendant conducted most of his clients' securities transactions through a block 12 trading account (the "Block Account") at TD Ameritrade ("TDA"). The purpose of a 13 block trading account is to aggregate multiple clients' trades through a large "block" 14 transaction, and subsequently allocate those trades using an average execution price. 15 However, it is possible for an investment adviser to abuse the block trading practice by 16 waiting to see whether the stock price rises or falls before allocating the trade not based 17 on an average execution price but on the stock's performance since purchase. 18 Defendant was solely responsible for placing trades through the Block Account 19 and allocating them between his clients' brokerage accounts ("Client Accounts") and his 20 own brokerage account ("Werthe Account").³ TDA was the broker-custodian which held 21 22 23 24 1 Unless noted otherwise, background facts are taken from the joint statement of 25 undisputed facts ("ECF No. 29, "JSUF"). 26 2 Mr. Werthe and HSR are sometimes collectively referred to as Defendant. 27 3 The Werthe Account and the Client Accounts are sometimes referred to as favored 28 1 the Werthe and Client Accounts, and through which Defendant executed the trades and 2 allocations. 3 In the fall 2021, TDA's data showed that Defendant was engaged in preferentially 4 allocating day-trades to the Werthe Account. On or about September 29, 2021, a TDA 5 representative told Mr. Werthe that he should avoid trading the same security on the same 6 day as his clients to avoid receiving a better price. On or about October 21, 2021, another 7 TDA representative questioned Mr. Werthe about his block trading, account allocations, 8 and inconsistencies between the representations to Defendant's clients and the actual 9 trading practices. The same representative again spoke with Mr. Werthe on March 4, 10 2022, and confronted him, among other things, about the broken assurance that he would 11 stop allocating day-trades to the Werthe Account and failure to retain allocation records. 12 On or about March 25, 2022, TDA shut down the Block Account and terminated its 13 relationship with HSR due to concerns about trading activity. 14 The SEC filed this action alleging that Defendant "cherry picked" the trades, i.e. 15 disproportionately allocated trades that were profitable at the time of allocation to the 16 Werthe Account and the trades that were unprofitable at the time of allocation

to the 17 Client Accounts. The SEC expert and financial economist Rachita Gullapali, Ph.D., 18 analyzed TDA trading and market quotation data and concluded that Defendant had 19 engaged in cherry picking. The SEC also alleged that Defendant made false or 20 misleading representations to his clients regarding his trading practices. 21 Based on the foregoing, the SEC alleged five causes of action. In the first cause of 22 action the SEC claims that by cherry picking Defendant engaged in a scheme to defraud 23 his clients and that he engaged in additional deceptive acts by making false and 24 misleading statements. The SEC contends that this conduct constituted fraud in 25 connection with the purchase or sale of securities in violation of 15 U.S.C. § 78j(b) and 17 26 // / / / / 27 28 1 C.F.R. § 240.10b-5(a) & (c). In the third cause of action the SEC claims that by the 2 same conduct Defendant also committed fraud in the offer or sale of securities in 3 violation of 15 U.S.C. § 77q(a)(1) and (3).⁵ The first and third causes of action are 4 collectively referred to as the “Fraudulent Scheme Claims.” 5 In the second cause of action the SEC claims that by making false statements to his 6 clients, Defendant engaged in fraud in connection with the purchase or sale of securities 7 in violation of 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5(b). Based on the same 8 alleged false statements, in the fourth cause of action the SEC claims that Defendant also 9 committed fraud in the offer or sale of securities in violation of 15 U.S.C. § 77q(a)(2). 10 The second and fourth causes of action are collectively referred to as the “False 11 Statement Claims.” 12 In the fifth cause of action the SEC claims that by cherry picking and false and 13 misleading statements Defendant breached his fiduciary duty to his clients. The SEC 14 contends that this conduct constitutes fraud by an investment adviser in violation of 15 15 U.S.C. § 80b-6(1) and (2)⁶ (the “Investment Adviser Claim”). 16 The SEC seeks injunctive relief, disgorgement of funds received from illegal 17 conduct, and civil penalties. The Court has subject matter jurisdiction over this action 18 under 28 U.S.C. § 1331. The SEC moves for summary adjudication of liability on all its 19 claims. 20 21

4 Title 15 U.S.C. § 78j(b) is sometimes referred to as Section 10(b) of the Securities
22 Exchange Act of 1934 (“Exchange Act”). Title 17 C.F.R. § 240.10b-5, the regulations 23 promulgated under Section 10(b), are sometimes referred to as Rule 10b-5. They apply to securities buyers and sellers. *Aaron v. SEC*, 446 U.S. 680, 687 (1980). 24 25 5 Title 15 U.S.C. § 77q(a) is sometimes referred to as Section 17(a) of the Securities Act of 1933 (“Securities Act”). It applies only to securities sellers. *Aaron*, 446 U.S. at 26 687. 27

6 Title 15 U.S.C. § 80b-6 is sometimes referred to as Section 206 of the Investment

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1 II. DISCUSSION

2 Federal Rule of Civil Procedure 56 empowers the Court to enter summary 3 judgment on factually unsupported claims or defenses. Summary judgment or 4 adjudication of issues is appropriate if depositions, answers to interrogatories, and 5 admissions on file, together with the affidavits, if any, show there is no genuine dispute 6 as to any material fact and the moving party is entitled to judgment as a matter of law. 7 Fed. R. Civ. P. 56(a). A fact is material when, under

the governing substantive law, it 8 could affect the outcome of the case. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 9 (1986).⁷ A dispute about a material fact is genuine if “the evidence is such that a 10 reasonable jury could return a verdict for the nonmoving party.” *Id.* 11 The burden on the party moving for summary judgment depends on whether it 12 bears the burden of proof at trial. As the plaintiff, the SEC has the burden of proof. 13 When the party moving for summary judgment would bear the burden of proof at trial, it must come forward with evidence which would entitle it to a 14 directed verdict if the evidence went uncontroverted at trial. In such a case, 15 the moving party has the initial burden of establishing the absence of a genuine issue of fact on each issue material to its case. 16 17 *C.A.R. Transp. Brokerage Co., Inc. v. Darden Rest., Inc.*, 213 F.3d 474, 480 (9th Cir. 18 2000); see also *Rookaird v. BNSF Ry. Co.*, 908 F.3d 451, 459 (9th Cir. 2018) (“Where 19 the moving party will have the burden of proof at trial, the movant must affirmatively 20 demonstrate that no reasonable trier of fact could find other than for the moving party.”). 21 If the moving party carries its burden of production, the nonmoving party must “go 22 beyond the pleadings and by [its] own affidavits, or by the depositions, answers to 23 interrogatories, and admissions on file, designate specific facts showing that there is a 24 genuine issue for trial.” *Celotex Corp. v. Catrett*, 477 U.S. 317, 324 (1986)). The 25 nonmoving party 26 27 7 Unless otherwise noted, internal quotation marks, ellipses, brackets, citations, and 28 1 must do more than simply show that there is some metaphysical doubt as to the material facts[, and] must come forward with specific facts showing that 2 there is a genuine dispute for trial. Where the record taken as a whole could 3 not lead a rational trier of fact to find for the non-moving party, there is no genuine issue for trial. 4 5 *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986). 6 Defendant opposing the SEC’s summary judgment motion is proceeding pro se. 7 Because he is not a prison inmate but “an ordinary pro se litigant, [he must,] like other 8 litigants, ... comply strictly with the summary judgment rules.” *Soto v. Sweetman*, 882 9 F.3d 865, 872 (9th Cir. 2018). 10 In ruling on a motion for summary judgment, “courts may not resolve genuine 11 disputes of fact in favor of the party seeking summary judgment.” *Tolan v. Cotton*, 572 12 U.S. 650, 656 (2014). “[A] judge’s function at summary judgment is not to weigh the 13 evidence and determine the truth of the matter but to determine whether there is a 14 genuine issue for trial.” *Id.* “[T]he evidence of the nonmovant is to be believed, and all 15 justifiable inferences are to be drawn in his favor.” *Id.* at 651; see also *id.* at 657. 16 “Credibility determinations, the weighing of the evidence, and the drawing of legitimate 17 inferences from the facts are jury functions, not those of a judge.” *Anderson*, 477 U.S. at 18 255. 19 A. The Fraudulent Scheme Claims 20 The Fraudulent Scheme Claims are based on the allegations of cherry picking and 21 false and misleading statements to clients in violation of Section 10(b) of the Exchange 22 Act, Rule 10b-5(a) & (c), and Section 17(a)(1) and (3) of the Securities Act.

23 Section 10(b) of the Exchange Act provides in relevant part as follows:

24 Manipulative and deceptive devices 25 It shall be unlawful for any person, directly or

indirectly, by the use of any 26 means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—[¶] 27 28 / / / / 1 (b) To use or employ, in connection with the purchase or sale of any security ... any manipulative or deceptive device or contrivance in contravention of 2 such rules and regulations as the Commission may prescribe as necessary or 3 appropriate in the public interest or for the protection of investors. 4 5 15 U.S.C. § 78j(b). Rule 10b-5 provides in relevant part: 6 Employment of manipulative and deceptive devices. 7 It shall be unlawful for any person, directly or indirectly, by the use of any 8 means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, 9 10 (a) To employ any device, scheme, or artifice to defraud, [¶] or 11 (c) To engage in any act, practice, or course of business which operates or 12 would operate as a fraud or deceit upon any person, 13 in connection with the purchase or sale of any security. 14 15 17 C.F.R. § 240.10b-5(a) & (c). Section 17(a) of the Securities Act provides in relevant 16 part: 17 Fraudulent interstate transactions 18 (a) Use of interstate commerce for purpose of fraud or deceit 19 It shall be unlawful for any person in the offer or sale of any securities ... by 20 the use of any means or instruments of transportation or communication in 21 interstate commerce or by use of the mails, directly or indirectly— 22

(1) to employ any device, scheme, or artifice to defraud, or [¶]

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(3) to engage in any transaction, practice, or course of business which

24 operates or would operate as a fraud or deceit upon the purchaser. 25 26 15 U.S.C. § 77q(a)(1) & (3). 27 These provisions require proof of (1) a fraudulent scheme, device or artifice to 28 defraud or transaction, act, practice, or course of business that operates as a fraud; (2) in 1 connection with the purchase, offer, or sale of a security; (3) through use of interstate 2 commerce. In addition, proof of scienter is required for all, except the claim alleged 3 under Section 17(a)(3) of the Securities Act, which requires only proof of negligence. 4 Aaron v. SEC, 446 U.S. 680, 701-02 (1980). The SEC provided evidence in support of 5 each element. 6 1. Scheme to Defraud 7 The SEC claims that by cherry picking and making false and misleading 8 statements to his clients, Defendant engaged in a scheme to defraud. 9 a. Cherry Picking 10 The SEC filed voluminous evidence in support of its motion. (ECF Nos. 26-5 11 through 26-25.) Much of this evidence was later subsumed in the joint statement of 12 undisputed facts. (See ECF No. 29.) Specifically in support of its cherry-picking claim, 13 the SEC provided expert testimony of Rachita Gullapalli, Ph.D. (ECF No. 26-21, 14 “Report;” ECF No. 26-22, “Supp. Report;” ECF No. 26-3, “Expert Decl.,” Gullapalli 15 Dep.8). Dr. Gullapalli opined that Defendant cherry picked for his own gain the trades he 16 made through the Block Account between May 1, 2021, and March 25, 2022. 17 Defendant started allocating Block Account trades to the Werthe Account in

18 September 2020; however, only seven such allocations were made before May 1, 2021,

19 when the allocations increased significantly. From May 1, 2021, until March 25, 2022, 20 more

than 90% of Defendant's trades were made in the aggregate through the Block 21 Account rather than directly.⁹ It is undisputed that Mr. Werthe was solely responsible for 22 placing trades through the Block Account and allocating them between the Werthe and 23 24 25 8 Both sides filed excerpts from Dr. Gullapalli's deposition. The excerpts can be found at ECF Nos. 26-20; 27; and 28-3. All excerpts collectively are referred to as 26 "Gullapalli Deposition." 27 9 A direct trade is not allocated because it is made for a specific account rather than 28 1 Client Accounts. (JSUF ¶ 9.) The allocation of trades stopped after March 25, 2022, 2 when TDA closed the Block Account. 3 Dr. Gullapalli analyzed the Block Account trades during the relevant period 4 between May 1, 2021, and March 25, 2022. These trades involved stocks and ETFs. 5 After making trades, Defendant allocated them from the Block Account to the Werthe 6 Account and various Client Accounts. At the time of allocation Defendant could 7 determine whether the investment had increased or decreased in price. Defendant 8 disproportionately allocated trades that were profitable at the time of allocation to the 9 Werthe Account and trades that were unprofitable at the time of allocation to the Client 10 Accounts. Defendant allocated trades totaling \$33,341,414 (based on the purchase price) 11 to the Werthe Account and earned a profit of \$471,885. He allocated trades totaling 12 \$43,846,546 (based on the purchase price) to the Client Accounts, which collectively 13 incurred a loss of \$555,485. 14 Dr. Gullapalli calculated the return earned between the time of purchase and time 15 of allocation for the Werthe Account and the Client Accounts.¹⁰ This rate is not 16 annualized but represents the average first day return attributable solely to the allocation 17 decisions (the "Allocation Return"). The Allocation Return for the Werthe Account was 18 1.42% and the Allocation Return for the Client Accounts was -1.27% (a negative return, 19 i.e., a loss). If all Block Account trades had been allocated equally, all accounts would 20 have had an Allocation Return of -0.11%. 21 Using two types of statistical analysis, Dr. Gullapalli determined that the difference 22 in performance between the Werthe Account and Client Accounts was not attributable to 23 random chance. The difference in performance also could not be accounted for by the 24 difference between the short-term highly competitive strategy Mr. Werthe used for his 25 personal account and the long-term buy-and-hold strategy he used for his clients. Nor 26 27 28 10 1 was the difference attributable to stock selection, because Defendant was trading in the 2 same stocks for himself and his clients. Because Defendant had the opportunity to cherry 3 pick the Block Account trades for his benefit, and because the superior performance of 4 the Werthe Account could not be otherwise accounted for, Dr. Gullapalli concluded that 5 Defendant was cherry picking. 6 Defendant attacks Dr. Gullapalli's opinion on several grounds. First, he argues 7 that she is not sufficiently experienced to render an opinion about cherry picking because 8 she had never authored a report analyzing cherry picking and because she is not an expert 9 in stock trading. (See Gullapalli Dep. at 10 ("not claiming to be an expert in stock 10 trading").) 11 A testifying expert must be qualified "by knowledge, skill, experience, training, or 12 education." Fed. R. Evid. 702. This rule "contemplates a broad conception of expert 13 qualifications." *Hangarter v. Provident Life*, 373 F.3d 998, 1018 (9th Cir.

2004) (emph. 14 in orig.). In 2001, Dr. Gullapalli earned an M.S. in applied economics and finance at 15 University of California, Santa Cruz. (Report App'x A.) In 2012, she earned a Ph.D. in 16 economics at University of California, Berkeley. (Id.) She has been employed at the 17 SEC as a Senior Financial Economist, Division of Economic and Risk Analysis, since 18 2012. (Id.) Her experience, including as a testifying expert, covers economic analysis 19 and statistical analysis regarding market manipulation trading schemes and preferred 20 allocation schemes by investment advisors. (Id.; see also Gullapalli Dep. at 9.) 21 Specifically, she has analyzed ten to twelve cases for cherry picking. (Gullapalli Dep. at 22 42.) Dr. Gullapalli's qualifications lay sufficient foundation of knowledge, skill, 23 experience, training, and education to give expert testimony on the issues addressed in 24 her report. See Hangarter, 373 F.3d at 1016. 25 Second, Defendant argues that the performance difference between the Werthe and 26 Client Accounts is not due to cherry picking but the difference in investment strategies. 27 Defendant was using a long-term buy-and-hold strategy for his clients and a short-term 28 highly competitive strategy for his own account. In trading for his own account, he used 1 stop-loss and limit orders. He argues that the fact that time elapsed between the stock 2 trades and allocations, giving him an opportunity to determine whether the price has 3 increased or decreased, is irrelevant to the issue whether he was cherry picking because 4 he was using stop-loss and limit orders which had predetermined criteria for buy and sell 5 prices.¹¹ 6 Dr. Gullapalli addressed this issue in her Report. (Report ¶¶ 46-50; see also 7 Gullapalli Dep. at 20.) The difference in investment strategies, including the use of stop- 8 loss and limit orders when Defendant was trading for his own account, is irrelevant to 9 Defendant's allocations. (Gullapalli Dep. at 40.) When Defendant was using the Block 10 Account to trade in the aggregate for himself and his clients, he had a choice to allocate 11 the trades between the Werthe and Client Accounts. Defendant does not dispute this. 12 (See JSUF ¶¶ 7-10.) He does not contend that the use of stop-loss and limit orders 13 obviated the need for allocation. 14 Alternatively, Dr. Gullapalli's conclusion that the disproportionate returns for the 15 Werthe Account were due to cherry picking rather than the difference in investment 16 strategy is underscored by her analysis of Defendant's direct trade data. (Report ¶¶ 53- 17 57; see also Gullapalli Dep. at 20.) When Defendant was trading directly for the Werthe 18 Account or a Client Account, no allocations were necessary, thus obviating the 19 opportunity for cherry picking. The Allocation Return for direct trades on the Werthe 20 Account during the relevant period was -0.27% rather than 1.42% when he allocated 21 trades from the Block Account. Defendant does not dispute this analysis. 22 / / / / / 23 24 25 11 A stop-loss order is an order placed with a broker to buy or sell a specific stock when it reaches a certain price. www.investopedia.com/terms/stop-lossorder.asp (last 26 visited 3/4/20205). A limit order is used to buy or sell a security at a pre-determined 27 price and will not execute unless the security's price meets those qualifications. www.investopedia.com/terms/limitorder.asp (last visited 3/4/20205). See also Gullapalli 28 1 Third, Defendant argues that Dr. Gullapalli's opinions are incomplete because she 2 did not compare the realized rates of return¹² for the trades

allocated to the Werthe and 3 Client Accounts. (See Gullapalli Dep. at 16-17, 36.) Dr. Gullapalli addressed this issue 4 in her Report. (Report ¶¶ 15-16 & n.15; see also Gullapalli Dep. at 17.) She calculated 5 the returns earned at the time of allocation to analyze the impact of the allocation 6 decision. (Gullapalli Dep. at 36.) She did not include profits and losses earned after 7 allocation because those were caused by factors other than Defendant's allocation 8 decision. (Id. at 17.) Accordingly, realized rates of return are not relevant to the issue 9 whether Defendant was cherry picking when he allocated trades. 10 For the foregoing reasons, Defendant's arguments do not raise a genuine issue of 11 material fact regarding cherry picking. Defendant also has not retained an expert of his 12 own to refute or challenge Dr. Gullapalli's opinions. (JSUF ¶ 33.) 13 In his opposition, Defendant offers a general protestation that he did not cherry- 14 pick and did not know the price at the time of allocation. These statements are alleged in 15 his opposition brief and are not supported by a sworn declaration. Defendant has failed 16 to file competent evidence in opposition to summary judgment. See *Soto v. Sweetman*, 17 882 F.3d 865, 872-73 (9th Cir. 2018). Moreover, when, as here, the moving party has 18 carried its burden, the nonmoving party: 19 must do more than simply show that there is some metaphysical doubt as to material facts. ... [T]he nonmoving party must come forward with specific 20 facts showing that there is a genuine issue for trial. Where the record taken 21 as a whole could not lead a rational trier of fact to find for the non-moving party, there is no genuine issue for trial. 22 23 *Matsushita Elec. Indus. Co.*, 475 U.S. at 586-87 (emph. in orig.); see also *Scott v. Harris*, 24 550 U.S. 372, 380 (2007) ("When opposing parties tell two different stories, one of which 25 is blatantly contradicted by the record, so that no reasonable jury could believe it, a court 26 27 12 A realized rate is earned at the time of sale rather than at the time of allocation. 28 1 should not adopt that version of the facts for purposes of ruling on a motion for summary 2 judgment."). Viewing the facts in the light most favorable to Defendant, and drawing all 3 reasonable inferences in his favor, Defendant has presented insufficient evidence to raise 4 a genuine issue of material fact regarding cherry picking. 5 b. False Statements 6 In addition to cherry picking, the SEC points to Defendant's false and misleading 7 statements to clients regarding his trade practices. These statements were made primarily 8 in Defendant's Form ADV Part 2A (the "Brochure"), which Defendant distributed to all 9 his clients. (See JSUF ¶ 44.) 10 Form ADV is an SEC registration form for investment advisers and consists of two 11 parts, both of which are available to the public. www.investor.gov/introduction-investing/investing-basics/glossary/form-adv (last visited 3/5/2025). Part 2A 13 requires investment advisers to prepare narrative brochures that include ... disclosures of the adviser's business practices, fees, conflicts of interest, and 14 disciplinary information. The brochure is the primary disclosure document 15 for investment advisers and must be delivered to advisory clients. 16 17 Id.; see also www.sec.gov/files/formadv-instructions.pdf (last visited 3/5/2025). 18 Defendant reviewed and had final control and authority over the content and wording of 19 the Brochures. (JSUF ¶ 45.) 20 The March 23, 2020, November 15, 2021, and March 15, 2022, Brochures all 21 stated that 22 Mr. Werthe does not

transact in the same securities for personal accounts as he may buy or sell for Client accounts; however, HSR has adopted personal securities transaction policies in its Code, which all current and future HSR associated persons must follow. Specifically, the Code requires personnel to report personal trades and holdings and prohibits or requires pre-clearance for certain trades in certain circumstances.

27 (JSUF ¶ 46.)

28 / / / / 1 This statement was false insofar as Mr. Werthe transacted in the same securities for 2 his personal Werthe Account as for his clients. Defendant admits that the statement was 3 false from May 2020 to August 2021 (JSUF ¶ 48) and does not dispute Dr. Gullapalli's 4 finding that from May 1, 2021, to March 25, 2022, all allocations to Client Accounts 5 were in stocks that were also allocated to the Werthe Account (id. ¶ 47). Defendant 6 admits that he reviewed this statement and should have corrected it but did not. (Id. ¶ 7 50.) 8 The March 23, 2020, November 15, 2021, and March 15, 2022, Brochures also 9 stated that 10 HSR or individuals associated with HSR are permitted to buy or sell for their personal account(s) securities or investment products identical to those 11 recommended to or already owned by Clients. Additionally, HSR will not 12 cause Clients to buy a security in which HSR or such individuals have an ownership position. Nevertheless, to mitigate potential conflicts, HSR has 13 adopted a Code of Ethics, which outlines the procedures regarding personal 14 trading that must be followed (see details below). Additionally, as part of HSR's fiduciary duty to Clients, HSR and its supervised persons will 15 endeavor at all times to put the interests of the Clients first and at all times 16 are required to adhere to HSR's Code of Ethics. 17 18 (JSUF ¶ 52.) For the reasons stated in Section a. above, Defendant has not raised a 19 genuine issue of material fact regarding cherry picking. Accordingly, the statement in the 20 Brochure was false insofar as Mr. Werthe cherry picked the profitable trades for himself 21 and did not put his clients' interests first. 22 Defendant's Brochure dated March 23, 2020, stated that "HSR effects transactions 23 for each Client independently and does not aggregate trades." (JSUF ¶ 54.) This 24 statement was updated in the November 15, 2021, Brochure, which stated that "HSR 25 typically effects transactions for each Client independently. At times, when able to 26 and as applicable, the Firm can aggregate trades of accounts." (Id. ¶ 55.) 27 Dr. Gullapalli found that more than 90% of Defendant's trades were through the 28 Block Account. (Supp. Report ¶ 2.) Defendant admits that he "conducted most of his 1 clients' securities transactions through the ... Block Account[.]" (JSUF ¶ 6.) No genuine 2 issue of material fact remains whether the statements about not aggregating trades, 3 whether "typically" or not at all, were false. 4 Finally, after TDA shut down the Block Account and terminated its broker- 5 custodian relationship with HSR, Defendant informed his clients on March 27, 2022, that 6 "he himself intended to move all of his client accounts to another broker-custodian 7 because TDA's service level had decreased dramatically, and its costs are being added 8 incrementally." (JSUF ¶ 61.) This statement was misleading because it failed to disclose 9 that TDA had informed Defendant it had shut down the Block Account and was 10 terminating the

relationship due to “concerns about trading activity by HSR.” (See *id.* ¶¶ 11 59, 60.) 12 Based on the foregoing, the SEC has provided evidence that Defendant repeatedly 13 made false and misleading statements to his clients. Defendant has not raised a genuine 14 issue of material fact regarding the falsity or misleading nature of these statements. 15 c. Analysis

16 Section 10b of the Exchange Act prohibits the use of “any manipulative or 17 deceptive device or contrivance.” 15 U.S.C. § 78j(b). Rule 10b-5 defines manipulative 18 and deceptive devices alternatively as “device, scheme, or artifice to defraud[.]” 17 19 C.F.R. § 240.10b-5(a), or “act, practice, or course of business which operates or would 20 operate as a fraud[.]” *id.* § 240.10b-5(c). The same is prohibited by Section 17(a) of the 21 Securities Act, 15 U.S.C. § 77q(a)(1) & (3). “These provisions capture a wide range of 22 conduct.” *Lorenzo v. SEC*, 587 U.S. 71, 79 (2019). For example, a device “is simply that 23 which is devised, or formed by design[.]” a scheme “is a project, plan or program of 24 something to be done[.]” and artifice “is an artful stratagem or trick.” *Id.* at 78. 25 Cherry picking is a practice or scheme by which the investment adviser allocates 26 profitable trades to preferred accounts and unprofitable trades to disfavored accounts. 27 (Report ¶ 5.) This practice is difficult to detect. *SEC v. World Tree Fin., L.L.C.*, 43 F.4th 28 448, 462 (5th Cir. 2022) (“World Tree”). It was particularly deceptive to Defendant’s 1 clients because Mr. Werthe had “full and exclusive discretionary authority” over their 2 accounts to trade on their behalf “without prior permission,” and he did not keep records 3 of his Block Account allocations (JSUF ¶¶ 5, 39-42). It was therefore virtually 4 impossible for Defendant’s clients to discover preferential allocations. Defendant further 5 concealed his cherry-picking activity by making false and misleading statements. 6 Defendant’s conduct therefore meets the definition of prohibited activity under Section 7 10(b) of the Exchange Act, Rule 10b-5(a) and (c), and Section 17(a)(1) and (3) of the 8 Securities Act. See *World Tree*, 43 F.4th at 461. 9 2. *Scienter* 10 *Scienter* is required to establish violation of Section 10(b) of the Exchange Act,

11 Rule 10b-5(a) and (c), and Section 17(a)(1) of the Securities Act. *Aaron*, 446 U.S. at 701-12 02. Negligence is sufficient for Section 17(a)(3) of the Securities Act. *Id.*; *SEC v. Dain 13 Rauscher, Inc.*, 254 F.3d 852, 856 (9th Cir. 2001). 14 *Scienter* is a “mental state embracing intent to deceive, manipulate or defraud.” 15 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). It “can be established by 16 intent, knowledge, or in some cases recklessness.” *SEC v. Platform Wireless Int’l Corp.*, 17 617 F.3d 1072, 1092 (9th Cir. 2010) (“Platform Wireless”). In this regard, 18 reckless conduct may be defined as a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme 19 departure from the standards of ordinary care, and which presents a danger 20 of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it. [¶ T]he danger of 21 misleading buyers must be actually known or so obvious that any reasonable 22 man would be legally bound as knowing, and the omission must derive from something more egregious than even “white heart/empty head” good faith. 23 24 *Hollinger v. Titan Capital Corp.*, 914 F.2d 1546,

1569 (9th Cir. 1990) (en banc). 25 Scierter may be inferred from circumstantial evidence. Herman & MacLean v. 26 Huddleston, 459 U.S. 375, 390 n.30 (1983). “Summary judgment is generally 27 inappropriate when mental state is an issue, unless no reasonable inference supports the 28 / / / / 1 adverse party’s claim.” Vucinich v. Paine, Webber, Jackson & Curtis, Inc., 739 F.2d 2 1434, 1436 (9th Cir. 1984). 3 Cherry picking necessarily involves knowing and intentional conduct because it 4 consists of a series of deliberate decisions to allocate profitable trades to preferred 5 accounts. See World Tree, 43 F.4th at 463-64. According to Dr. Gullapalli’s Report, 6 Defendant benefitted by cherry picking during the relevant period in the sum of \$507,996 7 at the expense of his clients. (Report ¶¶ 58-60.) Defendant does not dispute Dr. 8 Gullapalli’s analysis (JSUF ¶ 31) and has not raised a genuine issue of material fact 9 regarding cherry picking (see Section 1.a. above). Misuse of client funds is 10 circumstantial evidence of intent to defraud. See United States v. Booth, 309 F.3d 566, 11 575 (9th Cir. 2002). 12 Moreover, the SEC has provided undisputed evidence that Defendant was 13 repeatedly put on notice by third parties that his trading practices might be improper and 14 the representations he made to his clients misleading. On or about September 29, 2021, 15 TDA’s Financial Risk Management representative Andrew Jones spoke with Mr. Werthe 16 because TDA’s data showed preferential allocations to the Werthe Account. (JSUF 17 ¶ 34.) Defendant admits he was told that he should not trade on the same securities as his 18 clients on the same day “to avoid the scenario of [Defendant] receiving a better price.” 19 (Id. ¶ 35.) Defendant was audited in the summer of 2021 by the California Department of 20 Financial Protection and Innovation (“DFPI”). (Id. ¶ 57.) In October 2021, DFPI 21 notified Defendant that it falsely stated in its March 23, 2020, Brochure that “HSR effects 22 transactions for each Client independently and does not aggregate trades.” (ECF No. 26- 23 7, SEC Ex. C (Mar. 23, 2020, Brochure); ECF No. 26-16, SEC Ex. K (Oct. 12, 2021, 24 DFPI letter to Mr. Werthe).) In its letter, DFPI instructed Defendant to amend the 25 Brochure accordingly. (JSUF ¶ 57.) On or about October 21, 2021, TDA Adviser 26 Services Investigator Joshua Barkelew questioned Mr. Werthe about block trading, 27 allocations, and inconsistencies between the Brochures and his actual trading practices. 28 (Id. ¶ 37.) Mr. Werthe admitted to Mr. Barkelew that he was not keeping records of his 1 allocation decisions. (Id. ¶ 39.) On or about March 4, 2022, Mr. Barkelew confronted 2 Mr. Werthe that despite his assurances on October 21, 2021, he was still allocating day- 3 trades to the Werthe Account, it appeared that he was allocating less profitable trades to 4 the Client Accounts, and still failed to retain records of allocation decisions. (Id. ¶¶ 41- 5 42.) 6 Moreover, Defendant admits that some statements he made to his clients were 7 false. For example, Defendant admits that he falsely represented to his clients that he 8 was not trading on the same securities. (JSUF ¶¶ 48-50.) Beyond this admission, 9 Defendant was the sole person responsible for allocations from the Block Account and 10 the sole person responsible for the content and wording of the Brochures (Id. ¶¶ 9, 45.) 11 In opposition, Defendant quibbles about what precisely Messrs. Jones and 12 Barkelew said to him. (See ECF No. 27, Def.’s Exs. D & E.) These contentions are 13 inadequate in light of Defendant’s subsequent admissions in the

joint statement of 14 undisputed facts. 15 Defendant also offers his unsworn blanket protestation that he did not know that he 16 was doing anything wrong. This is insufficient to raise a genuine issue of material fact. 17 See *Soto*, 882 F.3d at 872 (allegations not sufficient to oppose a summary judgment 18 motion). Moreover, the false statements in the Brochures about not aggregating trades 19 and prioritizing client interests over his own were so patently false that no reasonable jury 20 could conclude that they were not knowingly or recklessly made. See *Hollinger*, 914 21 F.2d at 1569 (danger of misleading “so obvious that the actor must have been aware of 22 it”); *Scott*, 550 U.S. at 380 (“blatantly contradicted by the record”). 23 3. Remaining Elements 24 Defendant admits that by purchasing and selling securities through the Block 25 Account, and allocating shares from the Block Account among the Werthe and Client 26 Accounts, he “used the means or instrumentalities of interstate commerce, of 27 the mails, or the facilities of a national securities exchange, and engaged in conduct 28 that was in connection with the offer, purchase, and sale of securities.” (JSUF ¶ 10.) 1 4. Conclusion 2 The SEC has met its burden of production on every element necessary to prove 3 liability under its Fraudulent Scheme Claims alleged under Section 10(b) of the Exchange 4 Act, Rule 10b-5(a) and (c), and Section 17(a)(1) and (3) of the Securities Act. Defendant 5 has failed to raise a genuine issue of material fact regarding these claims. 6 B. The False Statement Claims 7 The False Statement Claims are based on the statements in the Brochures as set 8 forth in Section A.1.b. above. The SEC alleges that these statements were made in 9 violation of Section 10(b) of the Exchange Act, Rule 10b-5(b), and Section 17(a)(2).

10 Section 10(b) of the Exchange Act provides in relevant part:

11 Manipulative and deceptive devices 12 It shall be unlawful for any person, directly or indirectly, by the use of any 13 means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—[¶] 14 15 (b) To use or employ, in connection with the purchase or sale of any security ... any manipulative or deceptive device or contrivance in contravention of 16 such rules and regulations as the Commission may prescribe as necessary or 17 appropriate in the public interest or for the protection of investors. 18 19 15 U.S.C. § 78j(b). Rule 10b-5(b) provides in relevant part: 20 Employment of manipulative and deceptive devices. 21 It shall be unlawful for any person, directly or indirectly, by the use of any 22 means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, [¶] 23 24 (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of 25 the circumstances under which they were made, not misleading [¶] 26 in connection with the purchase or sale of any security. 27 28 17 C.F.R. § 240.10b-5(b). Section 17(a)(2) of the Securities Act provides: 1 Fraudulent interstate transactions 2 (a) Use of interstate commerce for purpose of fraud or deceit 3 It shall be unlawful for any person in the offer or sale of any securities ... by 4 the use of any means or instruments of ... communication in interstate 5 commerce or by use of the mails, directly or indirectly—[¶] 6

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading[.] U.S.C. § 77q(a)(2). These provisions require proof of (1) material misrepresentation or omission; (2) in connection with the purchase, offer, or sale of a security; (3) through use of interstate commerce. Proof of scienter is required for claims under Section 10(b) and Rule 10b-5(b), *Platforms Wireless*, 617 F.3d at 1092, while negligence is sufficient for the claim asserted under Section 17(a)(2), *Aaron*, 446 U.S. at 701-02. The SEC provided undisputed evidence that Defendant's Brochures dated March 23, 2020, November 15, 2021, and March 15, 2022, contained false or misleading statements. (See Section A.1.b. above.) Defendant admits that he "reviewed, and had final control and authority over, the content and wording of these Brochures." (JSUF 20 ¶ 45.) Accordingly, Defendant was the "maker" of these statements. See *Janus Cap. 21 Group v. First Derivative Traders*, 564 U.S. 135, 142 (2011). Further, the SEC presented evidence that Defendant made the statements with scienter, and Defendant has failed to raise a genuine issue of material fact as to this element. (See Section A.2. above.) The Court therefore turns to the issue of materiality. "It is indisputable that potential conflicts of interest are material facts with respect to clients[.]" *Vernazza v. SEC*, 327 F.3d 851, 859 (9th Cir. 2003). Defendant does not dispute that the false representations in the Brochures concerned the issues whether he was trading in the same securities as his clients, whether he was aggregating trades, and whether he placed his clients' interests before his own. Dr. Gullapalli's Report and Supplemental Report show, and Defendant does not dispute, that Defendant traded in the same securities as his clients, used the Block Account for the vast majority of trades, allocated most of the profitable trades to his own account and most of the unprofitable trades to the Client Accounts, and earned a profit for himself at the expense of his clients. (See discussion in Section A.1. above.) Had Defendant truthfully disclosed these practices in the Brochures, he would have disclosed a conflict of interest. Accordingly, no genuine issue of material fact remains regarding the materiality of Defendant's false statements. Finally, the false statements must be made by the use of interstate commerce "in connection with" the purchase, offer, or sale of a security. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5(b); 15 U.S.C. § 77q(a)(2). "An instrumentality of interstate commerce includes the postal mails, e-mails, telephone, telegraph, telefax, interstate highway system, Internet and similar methods of communication and travel from one state to another within the United States." Ninth Cir. Manual of Model Civ. Jury Instr. ("9th Cir. Civ. Jury Instr."), Instr. 18.1. It is undisputed that Defendant distributed the Brochures to his clients. (JSUF ¶ 44.) Defendant does not dispute that he distributed them by the use of an instrumentality of interstate commerce. "In connection with" means that there was some relationship between the false statement and the purchase, offer, or sale of a security. See 9th Cir. Civ. Jury Instr. 18.1. For example, this requirement is satisfied if an investor "suffered an injury as a result of deceptive practices touching its sale of

22 securities[.]” Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 12- 23 13 (1971). It is undisputed that Defendant’s false statements concealed his cherry- 24 picking practice from his clients. Accordingly, the statements were made “in connection 25 with” Defendant’s Block Account trading. 26 Based on the foregoing, the SEC has met its burden to produce evidence in support 27 of its False Statement Claims alleged under Section 10(b) of the Exchange Act, Rule 10b- 28 / / / / / 1 5(b), and Section 17(a)(2) of the Securities Act. Defendant has failed to raise a genuine 2 issue of material fact regarding these claims. 3 C. The Investment Adviser Claim 4 The SEC claims that Defendant’s cherry picking, and false and misleading 5 statements violated Section 206(1) and (2) of the Advisers Act. These provisions state: 6 Prohibited transactions by investment advisers 7 It shall be unlawful for any investment adviser by use of the mails or any 8 means or instrumentality of interstate commerce, directly or indirectly— 9 (1) to employ any device, scheme, or artifice to defraud any client or 10 prospective client; [or] 11 (2) to engage in any transaction, practice, or course of business which 12 operates as a fraud or deceit upon any client or prospective client[.] 13 14 15 U.S.C. § 80b-6(1) & (2). Section 206 “establishes federal fiduciary standards to 15 govern the conduct of investment advisers.” Transam. Mtg. Advisors, Inc. v. Lewis, 404 16 U.S. 11, 17 (1979). Scierter is required to establish liability under subsection (1), 17 Vernazza, 327 F.3d at 860, while negligence is sufficient under subsection (2), World 18 Tree, 43 F.4th at 460. 19 Defendant admits that he is a registered investment adviser. (JSUF ¶ 1.) The SEC 20 has submitted evidence to show that Defendant engaged in a scheme to defraud his 21 clients with the requisite scienter, and Defendant has failed to raise a genuine issue of 22 material fact as to these elements. (See discussion in Sections A.1. and 2. above.) 23 Finally, Defendant admits that in conducting his fraudulent scheme, he used the means 24 and instrumentalities of interstate commerce. (JSUF ¶ 10.) 25 Based on the foregoing, the SEC has met its burden to produce evidence in support 26 of liability under its Investment Adviser Claim alleged under Section 206 of the Advisers 27 Act. Defendant has failed to raise a genuine issue of material fact regarding this claim. 28 / / / / /

1 III. CONCLUSION

2 For the reasons stated above, the SEC’s motion for summary adjudication of 3 Defendant’s liability under each cause of action alleged in the Complaint is granted. 4 IT IS SO ORDERED. 5 6 Dated: March 12, 2025 7 for Hon. M. James Lorenz 8 United States District Judge 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28