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**UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA**

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

vs.

DONALD J. KELLEN,

Defendant.

Case No.

COMPLAINT

Plaintiff Securities and Exchange Commission ("SEC") alleges:

JURISDICTION AND VENUE

1. The Court has jurisdiction over this action pursuant to Sections 20(b), 20(d)(1) and 22(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77t(b), 77t(d)(1) & 77v(a), and Sections 21(d)(1), 21(d)(3)(A), 21(e) and 27(a) of the

1 Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. §§ 78u(d)(1),
2 78u(d)(3)(A), 78u(e) & 78aa(a).

3 2. Defendant has, directly or indirectly, made use of the means or
4 instrumentalities of interstate commerce, of the mails, or of the facilities of a national
5 securities exchange in connection with the transactions, acts, practices and courses of
6 business alleged in this complaint.

7 3. Venue is proper in this district pursuant to Section 22(a) of the Securities
8 Act, 15 U.S.C. § 77v(a), and Section 27(a) of the Exchange Act, 15 U.S.C. § 78aa(a),
9 because certain of the transactions, acts, practices and courses of conduct constituting
10 violations of the federal securities laws occurred within this district. In addition,
11 venue is proper in this district because Defendant Donald J. Kellen resides in this
12 district.

13
14 **SUMMARY**

15 4. This case is about a “cherry-picking” scheme carried out by investment
16 adviser representative (“IAR”) Donald J. Kellen (“Kellen”).

17 5. From September 2011 through September 2015, Kellen served as the
18 IAR for approximately 40 clients of Laurel Wealth Advisors, Inc. (“LWA”). As is
19 the case at many advisory firms, Kellen traded securities on behalf of his clients in an
20 “omnibus account,” and then allocated each trade to individual client accounts.
21 Because these allocation instructions may be submitted to the brokerage firm after
22 trades are executed, an adviser using an omnibus account to trade has the opportunity
23 to “cherry-pick”—that is, to allocate the winning trades to some favored accounts,
24 and allocate the losing trades to other disfavored accounts. That is what Kellen did.

25 6. For more than three years, Kellen engaged in a “cherry-picking” scheme,
26 purchasing securities in his omnibus account but delaying the allocation of those
27 securities to individual accounts until after he had observed the securities’ price
28 movement during the rest of the trading day. With the benefit of that knowledge,

1 Kellen disproportionately allocated profitable trades to his personal accounts and
2 disproportionately allocated unprofitable trades to his clients' accounts. Kellen
3 profited from this scheme at his clients' expense. By engaging in this cherry-picking
4 scheme, Kellen violated the fiduciary duties he owed to his clients, and violated the
5 antifraud provisions of the federal securities laws.

6 7. By engaging in this conduct, Kellen violated the antifraud provisions of
7 Sections 17(a)(1) and 17(a)(3) of the Securities Act, Section 10(b) of the Exchange
8 Act, and Rule 10b-5 thereunder.

9 8. With this action, the SEC seeks permanent injunctive relief against
10 Kellen to prevent future violations of the federal securities laws, disgorgement of ill-
11 gotten gains along with prejudgment interest, and civil penalties.

12 13 **THE DEFENDANT**

14 9. Defendant Donald J. Kellen resides in Palos Verdes Estates, California.
15 Kellen has been associated with LWA as an investment adviser representative from
16 May 2011 to the present.

17 18 **RELATED PARTY**

19 10. Laurel Wealth Advisors, Inc., is a California corporation with its
20 principal place of business in La Jolla, California. LWA has been an SEC-registered
21 investment adviser since May 2011 and had \$1.2 billion in assets under management
22 as of October 2019. At all times relevant to the allegations, LWA utilized a third-
23 party brokerage provider to execute trades.

24 25 **THE ALLEGATIONS**

26 **A. Background**

27 11. Kellen was not a founder of LWA but was the first IAR to join LWA
28 after its formation in 2011.

12. As an IAR, Kellen owes a fiduciary duty to his clients.

13. LWA's advisory clients are individual retail investors.

14. LWA's clients each pay LWA an advisory fee based on assets under management, generally 1%, of which Kellen receives 80% and LWA 20%.

15. From September 2011 through September 2015, Kellen served as the IAR for approximately 40 retail investor clients, managing approximately 51 client brokerage accounts.

16. During this time, Kellen also maintained three personal accounts at LWA.

B. Kellen's Trading Practices

17. Kellen used an omnibus account with LWA's brokerage services provider to place securities trades for his clients' accounts and for his own accounts.

18. During this period, Kellen would also sometimes place securities trades directly in his personal and clients' accounts, without use of the omnibus account.

19. In general, an omnibus trading account allows an investment adviser to buy and sell securities on behalf of multiple clients simultaneously, without identifying to the broker in advance the specific accounts for which a trade is intended.

20. As an example, if an adviser separately purchases the same security for several clients on the same day, the adviser might obtain different prices on each transaction as a result of normal market fluctuation. Rather than placing individual orders in each client account, the adviser can place an aggregated order, or "block trade," in the omnibus account and subsequently allocate the trade among multiple accounts using an average price. When used properly, an adviser will fairly and equitably allocate the block trade among client accounts, ensuring that no account receives preferential treatment over another.

21. Kellen had discretionary trading authority for most of his clients' accounts. Based on 32 investment advisory contracts for Kellen's clients produced

1 by LWA, 28 clients granted Kellen discretionary authority, two clients declined to
2 grant discretionary authority, and two clients did not choose either option.

3 22. Whether or not he had discretionary trading authority for a client's
4 account, Kellen alone made the investment and allocation decisions for trades in the
5 omnibus account and did not document his clients' trade approvals, his intentions for
6 allocations, or his reasoning for allocations.

7 23. Kellen's general practice was to place trade orders with the brokerage
8 provider by telephone.

9 24. As part of his general practice, after an order or multiple orders were
10 executed in the omnibus account, Kellen instructed the brokerage provider's trading
11 desk by telephone as to the allocation of these positions to himself and his clients.

12 25. Kellen alone made the decision as to the allocation of positions from the
13 omnibus account.

14 26. Although the brokerage provider's trading platform allowed him to pre-
15 allocate orders in the omnibus account, Kellen says he never did so, and there is no
16 record of his ever using pre-allocation functionality.

17 27. Instead, Kellen only issued allocation instructions to the brokerage
18 provider after he had an opportunity to observe a position's performance.

19 **C. Kellen's Cherry-Picking**

20 **1. The Cherry-Picking Scheme**

21 28. From about May 2012 through September 2015, Kellen misused his
22 omnibus account for his personal financial benefit rather than its intended purpose to
23 facilitate purchases of securities for multiple client accounts.

24 29. During this period, Kellen primarily allocated profitable trades to two
25 non-retirement personal accounts in his name ("Favored Accounts").

26 30. At the same time, Kellen primarily allocated unprofitable trades to his
27 clients' accounts ("Disfavored Accounts").

28 31. Kellen executed the cherry-picking scheme by trading in the omnibus

1 account and then delaying allocation of trades to a specific account until he had an
2 opportunity to observe the security's intra-day performance.

3 32. If the relevant security's price closed higher, Kellen generally allocated
4 the trade to the Favored Accounts, thereby receiving an unrealized gain.

5 33. For example, at 10:11 a.m. on June 16, 2014, Kellen placed a purchase
6 order in the omnibus account for 700 shares of a stock at \$22.69/share. The stock
7 rose, and just before market close, at 3:57 p.m., he allocated the position to himself.
8 The closing price that day was \$23.56, yielding a riskless first-day unrealized profit
9 of more than 3%.

10 34. Conversely, when the security's price went down over the course of the
11 day, Kellen generally allocated the purchase to the Disfavored Accounts, leaving
12 those accounts with unrealized first-day losses.

13 35. For example, at 10:49 a.m. on October 10, 2014, Kellen placed a
14 purchase order in the omnibus account for 500 shares of a stock at \$97.17/share. The
15 stock declined over the course of the day, closing at \$94.36. At 4:04 p.m. that day
16 just after market close, Kellen allocated the entire position to a client account,
17 saddling that client with an unrealized first day loss of 2.9% on that investment.

18 36. In some instances, Kellen purchased and sold the securities on the same
19 day, thus locking in a realized gain or loss, and then disproportionately allocated
20 profitable trades to the Favored Accounts, and unprofitable trades to the Disfavored
21 Accounts.

22 37. For example, at 9:46 a.m. on September 2, 2014, Kellen placed a
23 purchase order in the omnibus account for 1,000 shares of a stock at the price of
24 \$21.25/share. By 2:36 p.m., the price per share had risen to almost \$22.50, and
25 Kellen allocated the entire position to himself. Minutes after allocating the position
26 to himself, Kellen sold it for \$23.05 per share, a riskless profit of 8.5%.

27 ///

28 ///

2. The Remarkably Disproportionate Success of Allocations to the Favored Accounts versus Allocations to the Disfavored Accounts

38. From May 2, 2012, to September 11, 2015, Kellen allocated 2,260 positions from the omnibus account, with 702 allocations to the Favored Accounts and 1,558 allocations to the Disfavored Accounts.

39. Of the 702 allocations to the Favored Accounts, 74.6% were “winners” in that the prices of the allocated positions were higher at either the same day’s close or sale (in a day trade) than the purchase price.

40. In other words, at the end of a trade’s first day, over 74% of the positions allocated to the Favored Accounts had either realized or unrealized gains, which resulted in a cumulative first-day return (“profit rate”) of 0.92% for the Favored Accounts.

41. Kellen’s total first day net gains (realized and unrealized) on the 702 allocations to the Favored Accounts was \$162,021.

42. In contrast to the allocations to the Favored Accounts, of the 1,558 positions allocated to the Disfavored Accounts, only 37% were “winners.” The “profit” rate for the trades allocated to the Disfavored Accounts was -0.52%.

43. These 1,558 allocations to Kellen’s clients’ accounts amounted to total first day net losses (realized and unrealized) of -\$369,510.

44. As a subset of the 702 allocations to the Favored Accounts, Kellen’s day-trading through his omnibus account was even more successful. A staggering 99.0% of the 309 day trades allocated to the Favored Accounts were profitable at a profit rate of 1.05%.

45. The total first day net gains from Kellen’s allocations of day-trades to the Favored Accounts amounted to \$133,648, or 83% of the total first day net gains from all of the allocations to the Favored Accounts.

46. During this same time period, Kellen allocated only eight day trades to his clients’ Disfavored Accounts, of which only 62.5% were profitable at an overall

1 profit rate of only 0.30%.

2 47. The total first day net gains from day-trading allocations to the
3 Disfavored Accounts amounted to only \$697.

4 **3. Kellen's Suspicious Allocations Resulted in the Revocation of his**
5 **Omnibus Account Access**

6 48. By June 2015, the brokerage provider's compliance department took
7 note of Kellen's remarkably successful personal day trading in the same securities
8 and quantities that he also traded for his clients. During a June 4, 2015,
9 teleconference with LWA's principals, the brokerage provider's compliance
10 department communicated concerns about Kellen's use of the omnibus account.

11 49. In July 2015, LWA required Kellen to sign a letter stating that he would
12 not day trade in securities held by his clients and would place his personal trades
13 directly in his own accounts, rather than in the omnibus account.

14 50. However, even after signing this letter, Kellen continued to use his
15 omnibus account for his personal trading, resulting in the brokerage provider
16 temporarily restricting Kellen's omnibus account access in September 2015.

17 51. The brokerage provider permanently restricted Kellen's omnibus
18 account access in October 2015.

19 **4. The Selection of Securities Does Not Explain the Disparate**
20 **Performance of the Favored Accounts and Disfavored Accounts**

21 52. 87% of allocations to the Favored Accounts were for securities that
22 Kellen also traded for his clients at some point over the three-year period in which
23 Kellen used his omnibus account.

24 53. Thus, the disparity in returns between allocations to the Favored
25 Accounts and Disfavored Accounts cannot be explained by a difference in securities
26 purchased for the Favored Accounts and Disfavored Accounts.

27 54. Rather, the fact that Kellen and his clients largely traded in the same
28 securities enabled Kellen to allocate securities with first-day losses to his clients

1 without raising suspicion. More specifically, trading in the same securities as his
2 clients enabled Kellen to engage in riskless day trading, whereby Kellen sold a
3 position established earlier in the day that increased in value and allocated the buy
4 and sell trades to Favored Accounts. If a position decreased in value later in the day,
5 Kellen could allocate the unprofitable trade to Disfavored Accounts that typically
6 traded in the same securities.

7 **5. The Success of the Favored Accounts Was Due To Cherry-Picking**

8 55. Statistically, there is a vanishingly small chance of the disparity in
9 returns between the Favored and Disfavored Accounts occurring randomly. Even if
10 the allocations from the omnibus account were randomly assigned between the
11 Favored and Disfavored Accounts, and that random allocation were repeated many
12 times, it is virtually impossible that, in any one of those many instances, the Favored
13 Accounts would experience as much success as they did or the Disfavored Accounts
14 would lose as much as they did.

15 56. The incredible success of Kellen's personal trading is explained by his
16 practice of delaying the allocation of securities from his omnibus account until after a
17 successful day trade or, for positions held overnight, near or after the close of market.

18 57. Kellen admitted that he monitored the prices of securities he had already
19 purchased throughout the day. He therefore knew the intraday price movement of a
20 security after his purchase and before his allocation.

21 58. Records reflects that 323 allocations occurred at or after 4:00 p.m.
22 Eastern time, so Kellen would have known the closing price at the time of those
23 allocations.

24 59. Records reflect that 71% of positions opened in Kellen's omnibus
25 account were allocated to a single account, while only 29% were allocated to more
26 than one account. Rather than using the omnibus account for its intended purpose of
27 fairly allocating positions across multiple accounts, Kellen was abusing it to engage
28 in cherry-picking for his personal benefit.

60. Although Kellen's clients collectively absorbed nearly \$370,000 in allocated first-day losses, the overall performance of the stock market from 2012 through 2015 meant that Kellen's clients who held their securities positions generally saw their account values increase, thereby masking Kellen's scheme from his clients.

61. When Kellen didn't have the opportunity to cherry-pick, he was unable to recreate the remarkable success he experienced with allocations from the omnibus account to his Favored Accounts. When Kellen placed trades directly in his Favored Accounts, he had a win rate of only 45.0% and a profit rate of -0.1%. This disparate performance is explained by his inability to use the omnibus account to selectively allocate profitable trades to himself and unprofitable trades to his clients.

TOLLING OF THE STATUTE OF LIMITATIONS

62. Pursuant to a tolling agreement between Kellen and the SEC, the statute of limitations applicable to the SEC's claims against Kellen was tolled and suspended for the period beginning on March 2, 2018 through April 30, 2020.

FIRST CLAIM FOR RELIEF

Fraud in Connection with the Purchase or Sale of Securities

Violations of Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c)

63. The SEC realleges and incorporates by reference paragraphs 1 through 62 above.

64. As alleged above, Defendant Kellen engaged in a scheme to defraud clients, and engaged in acts, practices or courses of business that operated as a fraud upon clients, by cherry-picking profitable trades for the Favored Accounts and allocating unprofitable trades to the Disfavored Accounts.

65. By engaging in the conduct described above, Defendant Kellen directly or indirectly, in connection with the purchase or sale of a security, and by the use of means or instrumentalities of interstate commerce, of the mails, or of the facilities of

1 a national securities exchange: employed devices, schemes, or artifices to defraud;
2 and engaged in acts, practices, or courses of business which operated or would
3 operate as a fraud or deceit upon other persons.

4 66. Defendant Kellen, with scienter, employed devices, schemes and
5 artifices to defraud; and engaged in acts, practices or courses of conduct that operated
6 as a fraud on the investing public by the conduct described in detail above.

7 67. By engaging in the conduct described above, Defendant Kellen violated,
8 and unless restrained and enjoined will continue to violate, Section 10(b) of the
9 Exchange Act, 15 U.S.C. § 78j(b), and Rules 10b-5(a) and 10b-5(c) thereunder, 17
10 C.F.R. §§ 240.10b-5(a) & 240.10b-5(c).

11 12 **SECOND CLAIM FOR RELIEF**

13 **Fraud in the Offer or Sale of Securities**

14 **Violations of Sections 17(a)(1) and (3) of the Securities Act**

15 68. The SEC realleges and incorporates by reference paragraphs 1 through
16 62 above.

17 69. As alleged above, defendant Kellen engaged in a scheme to defraud
18 clients, and engaged in acts, practices or courses of business that operated as a fraud
19 upon clients, by cherry-picking profitable trades for the Favored Accounts and
20 allocating unprofitable trades to the Disfavored Accounts.

21 70. By engaging in the conduct described above, Defendant Kellen, directly
22 or indirectly, in the offer or sale of securities, and by the use of means or instruments
23 of transportation or communication in interstate commerce or by use of the mails
24 directly or indirectly: employed devices, schemes, or artifices to defraud; and
25 engaged in transactions, practices, or courses of business which operated or would
26 operate as a fraud or deceit upon the purchaser.

27 71. Defendant Kellen, with scienter, employed devices, schemes and
28 artifices to defraud; and, with scienter or negligence, engaged in transactions,

1 practices, or courses of business which operated or would operate as a fraud or deceit
2 upon the purchaser.

3 72. By engaging in the conduct described above, Defendant Kellen violated,
4 and unless restrained and enjoined will continue to violate, Sections 17(a)(1) and
5 17(a)(3) of the Securities Act, 15 U.S.C. §§ 77q(a)(1) & 77q(a)(3).

6
7 **PRAYER FOR RELIEF**

8 WHEREFORE, the SEC respectfully requests that the Court:

9 **I.**

10 Issue findings of fact and conclusions of law that Defendant committed the
11 alleged violations.

12 **II.**

13 Issue judgments, in forms consistent with Rule 65(d) of the Federal Rules of
14 Civil Procedure, permanently enjoining Defendant Kellen from violating Section
15 17(a) of the Securities Act [15 U.S.C. §77q(a)], and Section 10(b) of the Exchange
16 Act [15 U.S.C. §§ 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

17 **III.**

18 Order Defendant to disgorge all funds received from his illegal conduct,
19 together with prejudgment interest thereon.

20 **IV.**

21 Order Defendant to pay civil penalties under Section 20(d) of the Securities
22 Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. §
23 78u(d)(3)].

24 **V.**

25 Retain jurisdiction over this action in accordance with the principles of equity
26 and the Federal Rules of Civil Procedure in order to implement and carry out the
27 terms of all orders and decrees that may be entered, or to entertain any suitable
28 application or motion for additional relief within the jurisdiction of this Court.

VI.

Grant such other and further relief as this Court may determine to be just and necessary.

Dated: April 28, 2020

/s/ Daniel O. Blau

Daniel O. Blau

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Attorneys for Plaintiff

Securities and Exchange Commission