Initial Decision Release No. 1250
Administrative Proceeding
File No. 3-18061

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of

Retirement Surety LLC,
Crescendo Financial LLC,
Thomas Rose,
David Leeman, and
David Featherstone

Initial Decision
April 18, 2018

Appearances: Jennifer K. Vakiener, Steven G. Rawlings, and Jack Kaufman for the Division of Enforcement, Securities and Exchange Commission

Jeffrey J. Ansley and Gregory D. Kelminson, Bell Nunnally & Martin LLP, for Respondents

Before: Cameron Elliot, Administrative Law Judge

Summary

Thomas Rose, David Leeman, and David Featherstone brokered the sale of over $11 million in nine-month notes to dozens of investors. The Securities and Exchange Commission found that neither the three individual Respondents nor the securities that they sold were registered with the Commission. After imposing nonmonetary sanctions, the Commission ordered further proceedings to determine what, if any, monetary sanctions are appropriate. I grant the Division of Enforcement's motion for summary disposition. I impose full disgorgement and prejudgment interest on Rose and Featherstone and partial disgorgement on Leeman based on his demonstrated inability to pay. In addition, I impose first-tier civil penalties on Rose and Featherstone.

Procedural Background

On July 6, 2017, the Commission issued an order instituting proceedings (OIP) against Rose, Leeman, Featherstone, Retirement Surety LLC, and Crescendo Financial LLC pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940. The OIP alleges that Respondents willfully violated Section 5(a) and (c) of the Securities Act and Section 15(a)(1) of the Exchange Act by acting as unregistered brokers in the sale of unregistered securities—nine-month notes (Verto Notes)—issued by Verto Capital Management LLC. OIP ¶ II.

Respondents answered the OIP denying that they violated the securities laws. But they subsequently reached a partial accord with the Commission: On November 14, 2017, the Commission issued an order making findings and imposing nonmonetary sanctions. *Retirement Surety LLC*, Securities Act Release No. 10436, 2017 SEC LEXIS 3583 (Settlement Order). Respondents were ordered to cease and desist from future violations of Section 5(a) and (c) and Section 15(a)(1). Settlement Order ¶ VI.A. Retirement Surety and Crescendo agreed to dissolve. *Id.* ¶ III.E. Rose and Leeman received nine-month industry suspensions, and Featherstone was suspended for six months. *Id.* ¶ VI.B-.C.

Rose, Leeman, and Featherstone further agreed to continue this proceeding to determine what, if any, disgorgement, prejudgment interest, and civil penalties are appropriate. *Id.* ¶ IV. They agreed that—for the purpose of this proceeding—they may not dispute the Commission's finding that they violated the securities laws or any of the factual findings in the Settlement Order. *Id.* In addition, they agreed that the remaining issues may be decided on the basis of the written record without a hearing. *Id.*

The Division then moved for summary disposition on the monetary sanctions (Div. Mot.), relying almost entirely on the facts admitted in the Settlement Order. *See Retirement Surety LLC*, Admin. Proc. Rulings Release No. 4972, 2017 SEC LEXIS 2483, at *2 (ALJ Aug. 14, 2017) (granting leave to file motion for summary disposition). The individual Respondents submitted an opposition (Resp. Opp.) along with an appendix containing evidence regarding the public interest in monetary sanctions and their ability to pay (Resp. App.). The Division filed a reply (Div. Reply) and a declaration (Vakiener Decl.) with additional evidence concerning the public interest. On January 3, 2018, I determined that no hearing is necessary. *Retirement Surety LLC*, Admin. Proc. Rulings Release No. 5433, 2018 SEC LEXIS 15, at *1.

Decisional Standard

Summary disposition is appropriate where there is no genuine issue with regard to any material fact and the party making the motion is entitled to summary disposition as a matter of law. 17 C.F.R. § 201.250(c); *China-Biotics, Inc.*, Exchange Act Release No. 70800, 2013 WL 5883342, at *15 n.105 (Nov. 4, 2013) (summary disposition "has been applied in cases alleging a variety of securities law violations," not just in follow-on proceedings).

The findings and conclusions in this initial decision are based on the record and on facts officially noticed pursuant to Rule 323. *See* 17 C.F.R. § 201.323; *see also Robert Bruce Lohmann*, 56 S.E.C. 573, 583 n.20 (2003) (finding that matters "not charged in the OIP" may nevertheless be considered "in assessing sanctions"). In accordance with the terms of Respondents' settlement, I accept and deem true the factual findings in the Settlement Order. Settlement Order ¶ IV. All filings and all documents and exhibits of record have been fully reviewed and carefully considered. Preponderance of the evidence has been applied as the standard of proof. *See Steadman v. SEC*, 450 U.S. 91, 101-04 (1981). All arguments and proposed findings and conclusions that are inconsistent with this initial decision have been considered and rejected.

Findings of Fact

Respondents' unregistered brokering of the sale of unregistered Verto Notes

During the period relevant to this proceeding—November 2013 through November 2015—Rose, Leeman, and Featherstone brokered the sale of over $11 million of Verto Notes. Settlement Order ¶¶ III.C.12, 24.

Respondents were not registered with the Commission

Rose, Leeman, and Featherstone purported to be or to have been licensed as insurance agents in Texas. Settlement Order ¶¶ III.A.3-.5. But none of them held any securities licenses or have ever been registered as, or associated with, a registered broker-dealer. *Id.* Rose stated that they were aware that they were "obviously not securities licensed." Resp. App. at 1010.

The three were partners of Retirement Surety, a Texas limited liability company that was formed in 2010. Settlement Order ¶¶ III.A.1, 3-.5. Rose and Leeman were also partners of Crescendo, a second Texas limited liability company formed on June 18, 2013; Featherstone was a representative. *Id.* ¶¶ III.A.2-.5. During the relevant period, the companies' websites described both entities as "Christian organization[s]" comprised of "licensed partners"

from "outside of the financial services industry." *Id.* ¶¶ III.A.1-.2. Retirement Surety provided investment advice for retirement planning. *Id.* ¶ III.A.1. Crescendo's sole function was to broker the sale of Verto Notes. *Id.* ¶ III.A.2. Like the individual Respondents, Retirement Surety and Crescendo were never registered as, or associated with, a registered broker-dealer. *Id.* ¶¶ III.A.1-.2.

The offering of Verto Notes was not registered

The Verto Notes that were sold by Rose, Leeman, and Featherstone are nine-month, 7% promissory notes that were issued by Verto. Settlement Order ¶¶ III.B.9, .18, .27. Verto is one of several affiliated companies owned and operated by William R. Schantz III, a New Jersey resident who is not registered with the Commission and is not affiliated with a registered broker-dealer or investment adviser. *Id.* ¶ III.B.6. Schantz was last associated with a National Association of Securities Dealers member firm in 2000. *Id.*

In 2002, the NASD sanctioned and suspended him for having brokered the sale of unregistered nine-month promissory notes guaranteed by insurance companies without disclosing the sales to the NASD-member firm with which he was associated. *Id.* In 2006, Schantz entered into a consent order with the New Jersey Bureau of Securities as a result of those sales of unregistered securities and disgorged $7,000 in commissions that he earned from the sales. *Id.* In that order, the Bureau recognized that Schantz had believed that the notes were commercial paper that did not need to be registered and that despite a "good faith investigation" he did not know that the issuance of the notes was part of a Ponzi scheme. Consent Order as to William Schantz, Gerard Sherlock and Louis B. Mercaldo at 2-3, *In re Clearing Servs. of Am., Inc.*, No. BOS 1796-02 (N.J. Bureau of Sec. Jan. 18, 2006) ("*Clearing Servs.* Consent Order"), http://www.njconsumeraffairs.gov /Actions/20060117_ClearingServicesofAmericaIncschantz.pdf. The Bureau also noted that the administrative proceeding, which preceded the settlement, determined that Schantz did not know that the notes had to be registered and did not act with the intent to deceive or defraud investors. *Id.* at 3-4.

Like the nine-month notes that Schantz was sanctioned for brokering, the Verto Notes are securities. Settlement Order ¶ III.C.26.

The offering materials for Verto Notes stated that Verto was "engaged in the business of sourcing, valuing and selecting life insurance policies for resale to investors," which Verto called "Life Settlements." *Id.* ¶ III.C.13. The offering materials warned that if Verto "does not generate profits" then Verto "may be unable to repay all the promissory notes then outstanding

upon maturity." *Id.* ¶ III.C.14. Verto's lack of operating history was identified as a risk factor. *Id.* But the offering materials represented that the Verto Notes were secured by the "assignment and pledge of all of the Life Settlements owned by the issuer." *Id.* ¶ III.C.15.

No registration was filed or effective for the offering and sale of Verto Notes, and no valid exemption applied. *Id.* ¶ III.C.28. No Form D was filed with the Commission stating that Verto had complied with the exemption requirements in Securities Act Rule 506, 17 C.F.R. § 230.506. Settlement Order ¶ III.C.28.

Respondents brokered Verto Notes despite concerns that they were securities

Schantz recruited Rose to begin selling Verto Notes in late 2012 or early 2013. *See* Resp. App. at 1007. Rose and Leeman then formed Crescendo as a vehicle for the sale of the Verto Notes. *See* Settlement Order ¶ III.A.2. Rose stated that the Verto Note offerings caught his attention because he thought "it was not a security" based on the "advi[ce] by [Schantz] and his attorneys," including John Pauciulo. Resp. App. at 1007, 1011-12. Leeman knew that Pauciulo was "from a very large and reputable law firm in Philadelphia." *Id.* at 1002. Leeman also confirmed that he had received, directly or indirectly, Pauciulo's views and "the testimony of Mr. Schantz, who we believed would have never engaged in selling this if his attorney had said you better not, it is a security." Vakiener Decl. Ex. C at 3925. But Rose has acknowledged that Schantz's law firm was "[n]ot necessarily our law firm." Resp. App. at 1008.

Before November 2013, Crescendo hired its own attorney, David Shelmire, to be prepared to claim the collateral securing the Verto Notes in "the unlikely event" that it became necessary. *Id.* at 1009; Vakiener Decl. Ex. C at 3926-27, 3932-33. According to Leeman, it is "fair to say" that Shelmire was not retained to provide advice about the security laws. Vakiener Decl. Ex. C at 3933. Beyond that, however, Leeman asserted attorney-client privilege rather than provide any information about what advice was sought and received from Shelmire. *Id.* at 3926-27. Rose has asserted that Shelmire is a securities lawyer, but Leeman was unaware of his subject matter qualifications. *Compare id.* at 3927-28 *with* Resp. App. at 1010.

Rose and Leeman also did "Google searches" and other self-directed research to determine whether the Verto Notes were securities. Resp. App. at 1009-10; *see* Vakiener Decl. Ex. C at 3928. Rose looked at "an SEC document that says there [are] exemptions to a nine month note being a security" and "found other things out on the Internet from different law firms . . . saying, that nine month notes may or may not be a security." Resp. App.

at 1008. Leeman also looked at SEC documents and reviewed law firm websites. Vakiener Decl. Ex. C at 3928. Rose and Leeman do not identify which SEC or law firm guidance they reviewed.

Then, on November 15, 2013, Leeman received a call from another potential Verto Note broker. Vakiener Decl. Ex. A at 7917. The potential broker had retained an attorney, Thomas Sherman, to "do his due diligence," and Sherman "recommended that he not participate" based on Sherman's "opinion that [the Verto Note] is a security." *Id.*; Settlement Order ¶ III.C.27; *see* Vakiener Decl. Ex. B at 269-70. Leeman emailed Schantz to ask whether Schantz had ever taken the issue to his attorney. Vakiener Decl. Ex. A at 7917. Schantz replied that his "very good and expensive counsel" had "vet[ted] these issues and there is no problem at all." *Id.*

Sherman followed up by emailing Schantz a list of questions identifying issues with the Verto Notes offering under the Securities Act, the Exchange Act, and the Investment Company Act. Vakiener Decl. Ex. B at 269-70. Leeman was copied on the correspondence. *See id.* at 269. On November 20, 2013, he responded to Sherman: "So this is what it's all about!! The plot thickens. Nice that we have an attorney vetting the company for us on [the potential broker's] nickel!!" *Id.* Leeman concluded, "Sure hope it's all OK because I wrote up $75,000 today!" *Id.* Rose was aware that Sherman had advised his client against brokering the Verto Notes, but was not copied on the emails between Schantz, Sherman, and Leeman. *See* Resp. App. at 1002. There is no evidence that Leeman followed up with Sherman or Schantz about the issues that Sherman identified even though Rose and Leeman "wanted to make sure that what [they] were offering was not a security." Resp. App. at 1011.

Around the time that Leeman learned of Sherman's concerns, Respondents began to sell Verto Notes. *See* Settlement Order ¶ III.C.12. Rose and Leeman advertised the Verto Notes on at least two Christian radio networks. *Id.* ¶ III.C.18. The websites for Retirement Surety and Crescendo touted the Verto Notes' "Superior Returns" and emphasized their "Minimal Risk" because they were "200% collateralized." *Id.* ¶¶ III.C.18-.19. There is no evidence in the record regarding the truth of these statements or what the individual Respondents knew about the truth of these statements. While marketing the notes, Respondents expressly held themselves out as financial advisers. *Id.* ¶ III.C.25. And they knowingly sold the Verto Notes to at least five unaccredited investors, to whom they failed to provide any of the financial information required by Securities Act Rule 502(b)(2), 17 C.F.R. § 230.502(b)(2). *Id.* ¶ III.C.28.

After brokering the Verto Notes for approximately seven months, on June 24, 2014, Leeman emailed Schantz, copying Rose, to ask about Schantz's sale of unregistered nine-month securities that resulted in sanctions by NASD in 2002. *See id.* ¶ III.C.27. Leeman asked "[i]n the SEC issue you had for selling Promissory Notes in 2001 as non-securities when the SEC claimed that they *were* securities, what was the difference between those and what we have? It looks like they were also 9 month notes." *Id.*

In August 2014, Schantz forwarded to Rose and Leeman an email from Pauciulo stating that "providing a formal legal opinion on this point would not be feasible" because of its complexity. Resp. App. at 996. But Pauciulo stated that he "th[ought] that a regulator or court should find that the notes are exempt" and that they had been "drafted . . . with the intent to meet the requirements of the 9 month note exemption." *Id.* Pauciulo also suggested changing Respondents' compensation so that instead of receiving a commission from Verto, they would be paid "a fee for the purchaser" as a "purchaser representative." *Id.* at 996-97. Pauciulo offered to draw up the appropriate paperwork, *id.* at 997, but there is no evidence that he did so.

In addition, at some point, Rose, Leeman, and Featherstone learned of Schantz's 2006 consent order in New Jersey resulting from the same incident as the NASD sanctions. Settlement Order ¶ III.C.27.

When Verto was unable to repay investors under the terms of the Verto Notes, Rose, Leeman, and Featherstone presented investors with "forbearance agreements," which extended the terms of the Verto Notes. *Id.* ¶ III.C.22.

Respondents were enriched by brokering Verto Notes and there is some evidence that Respondents' customers were harmed

In sum, Rose, Leeman, and Featherstone sold $11,662,386 in unregistered Verto Notes to sixty-nine investors. Settlement Order ¶ III.C.24. They earned a 5% commission for each Verto Note that they sold, *id.* ¶ III.C.21, and an additional 4% commission for each forbearance agreement entered into by investors, *id.* ¶ III.C.22. As a result, Rose, Leeman, and Featherstone received the following compensation from the sale of Verto Notes and the offering of forbearance agreements (*id.* ¶ III.C.24):

	Rose	Leeman	Featherstone
Investors	37	24	8
Notes Sold	70	53	25
Principal of Notes Sold	$5,064,391	$4,227,540	$2,370,455
Commissions (Issuance)	$217,130	$212,263	$115,414
Commissions (First Forbearance)	$63,864	$18,459	$5,346
Commissions (Second Forbearance)	$16,366	$12,713	$0
Total Commissions	$297,360	$243,435	$120,760

Although Verto was unable to timely pay investors the amounts due under the original Verto Notes, *id.* ¶ III.C.22, there is little evidence in the record that Respondents' customers have lost money. Of the sixty-nine investors to whom Rose, Leeman, and Featherstone sold Verto Notes, eleven have stated that they received full return of their principal plus interest owed, Resp. App. at 1021-28, 1041-44, 1047-48, 1059-60, 1063-68, and another twelve have stated that as of January 2017 they were satisfied with the extended terms of their Verto Notes, *id.* at 1029-30, 1033-40, 1045-46, 1051-52, 1057-58, 1061-62, 1069-74.

There is no additional evidence in the record of the current status of payments on the Verto Notes, other than a statement in Rose's submissions indicating that as of 2017 he believes that the amount his wife is owed on her Verto Note will be repaid. *See id.* at 581. However, I take official notice of the Commission's settlement with Schantz and Verto in which they agree to pay disgorgement of $4,032,488, prejudgment interest of $21,772, and a civil penalty of $600,000, for a total of $4,654,260. Amended Final Judgment as to Defendants William R. Schantz and Verto Capital Management LLC at 7, *SEC v. Schantz*, No. 1:17-cv-3115 (D.N.J. Feb. 27, 2018), ECF No. 13 ("*Schantz* Judgment"). This settlement amount appears to be calculated to repay the outstanding principal on the Verto Notes and most, if not all, of the accrued interest. *See id.* at 5-6 (providing for the creation of a Fair Fund); Letter to Hon. Robert B. Kugler from Jennifer K. Vakiener, SEC, at 27-29, *Schantz* (D.N.J. Feb. 23, 2018), ECF No. 11. The terms of the settlement suggest that some investors have not yet been repaid, but Schantz and Verto do not admit any of the allegations in the complaint or in the final judgment. *Schantz* Judgment at 1, 5-6. And, even if the facts were admitted—or found by the fact finder after a contested proceeding—it is not clear from the publicly available information whether any of those investors were the individual Respondents' customers.

Respondents' present financial conditions

Rose

Rose is 62 years old, married, and self-employed. Resp. App. at 580; *see* Settlement Order ¶ III.A.3. Rose and his wife have no dependents. Resp. App. at 375. As of November 2017, their net worth was substantial, and they owned significant real and personal property. *Id.* at 365-66, 560-61. Between May 2017 and November 2017, Rose's and his wife's net worth decreased. *Id.* at 560. But there is no evidence that Rose and his wife attempted to reduce expenses. *See, e.g.*, *id.* at 461-558.[1] And as of December 2017, the household had a substantial net monthly income even after a change in employment. *Id.* at 372, 580-81; *see id.* at 371, 563, 580-81.

Leeman

Leeman is 68 years old, married, and self-employed. Resp. App. at 361; *see* Settlement Order ¶ III.A.4. Leeman and his wife have no dependents. Resp. App. at 10. As of May 2017, their net worth was less substantial than that of Rose and Featherstone. *Id.* at 1-3. In 2017, the household's net monthly income, although positive, was also less substantial than that of Rose and Featherstone. *Id.* at 359-60, 362. Leeman has a medical condition that may result in a significant financial burden. *Id.* at 361; *see id.* at 284-86.

Featherstone

Featherstone is 70 years old, married, and self-employed. Resp. App. at 995; *see* Settlement Order ¶ III.A.5. He and his wife have one adult dependent. Resp. App. at 587. As of May 2017, the net worth of Featherstone's household was substantial, and consisted of significant real and personal property. *Id.* at 582-84. The household's net monthly income was substantial. *Id.* at 585-87.

Sanctions

This proceeding is limited to the issue of monetary sanctions. Settlement Order ¶ VII. Respondents cannot contest the findings in the Settlement Order regarding their willful violations of Securities Act Section 5(a) and (c) and Exchange Act Section 15(a)(1). *Id.* ¶¶ III.D, IV. Those factual findings together with the parties' submissions concerning the

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[1] Rose submitted partially updated cash flow information, *see* Resp. App. at 563, 580-81, but did not update his May 2017 expenses. *See id.* at 372, 377.

individual Respondents' state of mind and ability to pay—insofar as the material facts are not in dispute—provide sufficient grounds to determine what sanctions are appropriate. *See* 17 C.F.R. § 201.250(c).

Disgorgement is appropriate

Disgorgement is authorized in this case by Securities Act Section 8A(e) and Exchange Act Sections 21B(e) and 21C(e). *See* 15 U.S.C. §§ 77h-1(e), 78u-2(e), 78u-3(e); Settlement Order ¶ IV. Disgorgement is an equitable remedy that requires a violator to give up wrongfully obtained profits causally related to the proven wrongdoing. *See SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230-32 (D.C. Cir. 1989). The amount of the disgorgement "need only be a reasonable approximation of profits causally connected to the violation." *Laurie Jones Canady*, 54 S.E.C. 65, 84 n.35 (1999) (quoting *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996)), *pet. denied*, 230 F.3d 362 (D.C. Cir. 2000). Once the Division shows that its disgorgement figure reasonably approximates the amount of unjust enrichment, the burden shifts to Rose, Leeman, and Featherstone to demonstrate that the Division's disgorgement figure is not a reasonable approximation. *Guy P. Riordan*, Securities Act Release No. 9085, 2009 WL 4731397, at *20 (Dec. 11, 2009), *pet. denied*, 627 F.3d 1230 (D.C. Cir. 2010). The standard for disgorgement is but-for causation and does not require analysis of public interest factors or consideration of the combination of sanctions. *Jay T. Comeaux*, Securities Act Release No. 9633, 2014 WL 4160054, at *3 & n.18, *4 n.32, *5 (Aug. 21, 2014).

Transaction-based compensation, such as the commissions received by Rose, Leeman, and Featherstone from their illegal activities, are a reasonable approximation of their ill-gotten gains. *E.g.*, *Ralph Calabro*, Securities Act Release No. 9798, 2015 WL 3439152, at *44-45 & n.233 (May 29, 2015); *Ronald S. Bloomfield,* Securities Act Release No. 9553, 2014 WL 768828, at *20-21 (Feb. 27, 2014) (ordering disgorgement of commissions for sale of unregistered securities), *partially vacated on other grounds, Robert Gorgia,* Securities Act Release No. 9743, 2015 WL 1546302 (Apr. 8, 2015), *pet. denied,* 649 F. App'x 546 (9th Cir. 2016). It is undisputed that Rose received $217,130 in commissions from his sales of unregistered Verto Notes, Leeman received $212,263, and Featherstone received $115,414. Settlement Order ¶ III.C.24, .26, .28-.29. Respondents further admit that Rose received $80,230 in commissions from arranging for investors to enter into forbearance agreements, Leeman received $31,172, and Featherstone received $5,346. *Id.* ¶ III.C.24. These amounts presumptively approximate the amount of unjust enrichment. *See* Div. Mot. at 9.

To rebut the Division's disgorgement request, the individual Respondents first contend that their total Verto-related commissions are not a reasonable approximation because they should be credited for taxes paid on their commission. Resp. Opp. at 13-14. Referring to *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), Rose, Leeman, and Featherstone assert that "for an amount to be truly remedial and not punitive, [I] should consider the taxes Respondents paid, in order to fully place them back to the status quo." Resp. Opp. at 14. But the Court's conclusion in *Kokesh* was that disgorgement in Commission enforcement cases was punitive and not remedial for purposes of the statute of limitations because it "sometimes exceeds the profits gained as a result of the violation"; as an example, the Court observed that marginal costs are sometimes *not* deducted from the amount disgorged, "leav[ing] the defendant worse off." 137 S. Ct. at 1644-45.

Indeed, the Commission normally declines to reduce disgorgement because a respondent has paid an ordinary tax liability. *See, e.g.*, *Canady,* 54 S.E.C. at 84 (respondent not "entitled" to reduction in disgorgement "based upon taxes she has paid . . . in connection with transactions here"); *accord, e.g.*, *SEC v. U.S. Pension Trust Corp.*, 444 F. App'x 435, 437 (11th Cir. 2011) (finding "no authority" for the deduction of income tax payments from the amount of disgorgement). Nothing in *Kokesh* disturbs that principle.

The individual Respondents' second argument is that their commissions for brokering the forbearance agreements should not be disgorged because the agreements are not securities. Resp. Opp. at 14-15. Because the forbearance agreements "did not require the investor[s] to add funds" they are neither notes nor investment contracts. *Id.*

This argument is beside the point because disgorgement of the forbearance agreement commissions is appropriate even if the agreements are not securities. To be ill-gotten gains, the individual Respondents' commissions must be only "causally related" to their securities violations. *Dennis J. Malouf*, Securities Act Release No. 10115, 2016 WL 4035575, at *26 (July 27, 2016), *corrected*, Securities Act Release No. 10207, 2016 WL 4761084 (Sept. 13, 2016), *pet. filed*, No. 16-9546 (10th Cir. Sept. 8, 2016); *see Comeaux*, 2014 WL 4160054, at *3 (requiring "but-for causation"). If they never brokered the sales of unregistered Verto Notes, then Rose, Leeman, and Featherstone would have not been able to obtain additional commissions by brokering the forbearance agreements to the same investors. The forbearance agreements would not have existed but for the unregistered securities. *See* Settlement Order ¶ III.C.22 (forbearance agreements "extended the terms of the Verto Notes"). Any profits from extending the terms of the Verto Notes were necessarily derivative of the original unregistered sales.

Prejudgment interest on disgorged amounts is appropriate

Payment of prejudgment interest is also warranted here. *See* 17 C.F.R. § 201.600(a) (prejudgment interest "shall be due on any sum required to be paid pursuant to an order of disgorgement"); *see also* 15 U.S.C. §§ 77h-1(e), 78u-2(e), 78u-3(e); Settlement Order ¶ IV. "[E]xcept in the most unique and compelling circumstances, prejudgment interest should be awarded on disgorgement . . . to deny a wrongdoer the equivalent of an interest free loan from the wrongdoer's victims." *Terence Michael Coxon*, Securities Act Release No. 8271, 2003 WL 21991359, at *14 (Aug. 21, 2003), *pet. denied*, 137 F. App'x 975 (9th Cir. 2005).

The Division has provided calculations for prejudgment interest that Rose, Leeman, and Featherstone do not challenge. *See* Div. Mot. at 11; *id.* Exs. 1-3. But the Division's calculations contain two unexplained errors. First, the Division assumes—without citing any evidence—that the full disgorgement amount accrued at the beginning of period during which Respondents admitted to receiving commissions for securities violations. *See id.* at 11 (calculating interest from November 1, 2013 based on admission that sales began in November 2013). Second, the Division calculates prejudgment interest during only the admitted period. *See id.* (calculating interest until December 31, 2016, based on admission that commissions were received through 2016).

In a different context it may be appropriate to consider the calculation errors forfeited—especially since each favors a different party. The rule authorizing prejudgment interest, however, is written in mandatory terms: "Prejudgment interest *shall* be due from the first day of the month following each [securities] violation through the last day of the month preceding the month in which payment of disgorgement is made" using the "rate of interest established under Section 6621(a)(2) of the Internal Revenue Code . . . compounded quarterly." 17 C.F.R. § 201.600(a)-(b) (emphasis added). The Division's calculations must therefore be revised.

I deem all of the violations to have occurred at the end of 2016 for purposes of calculating prejudgment interest, so interest must be calculated from January 1, 2017. *See* Settlement Order ¶ III.C.24; 17 C.F.R. § 201.600(a). I recognize that it is unlikely that all of Respondents' commissions were received in December 2016, but the failure to establish the specific dates by a preponderance of the evidence falls on the Division.[2]

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[2] In fact, there is some evidence in the record regarding when particular sales were brokered and commissions received, but the Division has not

(continued…)

Accord, e.g., *Coxon*, 2003 WL 21991359, at *14 (calculating prejudgment interest to "run from the date of the last violation"). From this revised date, interest must be calculated using the statutory rate compounded quarterly through the end of the month preceding the payment of any ordered disgorgement. *See* 17 C.F.R. § 201.600(a)-(b); *see also* 26 U.S.C. § 6621(a)(2); Quarterly IRS Interest Rates Used in Calculating Interest on Overdue Accounts and Refunds on Customs Duties, 83 Fed. Reg. 1,043, 1,044 (Jan. 9, 2018).

Civil monetary penalties are appropriate

Only first-tier penalties are appropriate

Civil penalties are authorized in this proceeding by Securities Act Section 8A(g) and Exchange Act Section 21B(a)(1)-(2) because the Commission found that Rose, Leeman, and Featherstone violated relevant provisions of the federal securities laws. 15 U.S.C. §§ 77h-1(g), 78u-2(a)(1)-(2); *see* Settlement Order ¶¶ D.1-.2. There is a three-tier system identifying the maximum amount of civil penalties, depending on the severity of the respondent's conduct. Third-tier penalties are awarded in cases where (1) violations involve fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, and (2) the conduct in question directly or indirectly resulted in substantial losses, or created a significant risk of substantial losses to other persons, or resulted in substantial pecuniary gain to the person who committed the act or omission. 15 U.S.C. §§ 77h-1(g)(2)(C), 78u-2(b)(3). Second-tier penalties require only the first factor and first-tier penalties require neither. 15 U.S.C. §§ 77h-1(g)(2)(A)-(B), 78u-2(b)(1)-(2). The Division requests the "maximum available" penalties. Div. Mot. at 11.

Rose, Leeman, and Featherstone knew that they were not registered broker-dealers or associated with a registered broker-dealer and, therefore, could not broker the sale of securities. Settlement Order ¶¶ III.A.3-.5; Resp. App. at 1010. They also knew that if the Verto Notes were securities, they were unregistered and could not be sold. *See* Resp. App. at 1011. There is no evidence of fraud, deceit, manipulation, or deliberate disregard of a regulatory requirement, and indeed, the Division argues only that the individual Respondents "recklessly ignored the risk that the notes were

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identified or relied on any of it. *See, e.g.*, Resp. App. at 361 (Leeman declaration providing his Verto-related income during 2014); *id.* at 1021 (investor declaration stating the amount and timing of Verto Note purchase brokered by Leeman).

securities." Div. Mot. at 14. Whether second- or third-tier penalties are appropriate therefore turns on whether Rose, Leeman, and Featherstone recklessly ignored that risk.

The evidence shows that the individual Respondents were negligent, but not reckless. *See SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992) (reckless conduct is "an extreme departure from the standards of ordinary care, . . . which presents a danger 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" (internal quotation marks omitted)); *Russell W. Stein*, 56 S.E.C. 190, 204 n.24 (2003) (adopting *Steadman*'s standard in reference to the "reckless disregard" requirement for civil penalties), *recons. granted*, Exchange Act Release No. 50168, 2004 WL 1778889 (Aug. 9, 2004). To be sure, Rose and Leeman did not adequately address the risk that the notes might be securities. Instead, they relied on the views of Schantz—the self-interested owner of Verto—and Pauciulo. Resp. App. at 1011-12; Vakiener Decl. Ex. C at 3925. They knew that Pauciulo was not their counsel, Resp. App. at 1008, and when they hired Shelmire as Crescendo's attorney, they did not consult him about whether Verto Notes are securities. Vakiener Decl. Ex. C at 3927, 3933. There is no evidence that after Sherman—an attorney independent of Schantz and Verto, although not Respondents' attorney—identified multiple issues with the unregistered sale of the Verto Notes, Vakiener Decl. Ex. B at 269-70, Rose or Leeman obtained answers to those issues before moving forward. Even seven months later, when Leeman copied Rose on an email asking Schantz about the difference between the unregistered nine-month notes that he was disciplined for selling and the ones that they were selling now, they did not balk at Pauciulo's statement that he could not provide a formal legal opinion. *See* Settlement Order ¶ III.C.27; Resp. App. at 996.

Nonetheless, three considerations weigh decisively against finding that Respondents acted recklessly. First, when they became aware that the notes' status might be problematic, Rose and Leeman independently investigated the question. Rose admitted that he was interested in brokering Verto Notes because, he thought, "it was not a security." Resp. App. at 1007. Rose and Leeman inquired of Schantz and his attorney, Pauciulo. Resp. App. at 1011-12; Vakiener Decl. Ex. C at 3925. Leeman believed that Schantz would not have sold the notes if Pauciulo had advised that they were securities. Vakiener Decl. Ex. C at 3925. And Pauciulo was an experienced partner in a large, reputable law firm, who stated that he "th[ought] that a regulator or court should find that the notes are exempt" even though he wouldn't provide an opinion letter. Resp. App. at 996 (assuring Schantz that "[w]e have drafted the documents with the intent to meet the requirements of the 9

month note exemption"); *see id.* at 1002. In addition, Rose and Leeman did their own internet research, finding posts on law firm websites and a Commission document stating that nine-month notes may not be securities. *See* Resp. App. at 1009-10; Vakiener Decl. Ex. C at 3928.

And Featherstone was not even cognizant of the regulatory risk until he became aware that Schantz had previously been disciplined for selling unregistered nine-month notes. Settlement Order ¶ III.C.27. There is no evidence that he knew about Sherman's concerns or heard that Pauciulo refused to provide a legal opinion letter. There is no evidence that he saw third-party law firm websites stating that nine-month notes may be securities depending on the circumstances. And although he was a partner in Retirement Surety—which existed years before the sale of Verto Notes—Featherstone was not one of the principals of Crescendo, *see* Settlement Order ¶¶ III.A.1-.2; there is no evidence that he was involved in hiring Shelmire or doing other diligence that might be expected of the company's managers.

Second, the factual record, in light of Respondents' regulatory obligations, only barely establishes that the Verto notes were securities. The Commission and the courts have interpreted the nine-month note exemption in a functional manner that makes sense in the context of the overall statutory scheme. *See Reves v. Ernst & Young*, 494 U.S. 56, 73 (1990) (giving little weight to possibility that "Congress intended to create a bright-line rule exempting . . . *all* notes of less than nine months' duration"); *id.* at 74 (Stevens, J., concurring) ("The Courts of Appeals have been unanimous is rejecting a literal reading of that exclusion."); *SEC v. Better Life Club of Am., Inc.*, 995 F. Supp. 167, 174 (D.D.C. 1998) (holding that the nine-month note exemption "is available only for true commercial paper—short-term, high quality instruments issued to fund operations, and sold only to sophisticated investors"), *aff'd*, 203 F.3d 54 (D.C. Cir. 1999); Interpretation of Section 3(a)(3), 26 Fed. Reg. 9,158, 9,159 (Sept. 29, 1961) ("section 3(a)(3) applies only to prime quality negotiable commercial paper of a type not ordinarily purchased by the general public"). But it is undeniable that the plain language of both the Securities Act and the Exchange Act appears to provide a bright-line exemption for nine-month notes. *See* 15 U.S.C. § 77c(a)(3) (excluding any "note . . . which has a maturity at the time of issuance of not exceeding nine months"); 15 U.S.C. § 78c(a)(10) (same).

The Settlement Order finds conclusorily that the notes were securities. Settlement Order ¶ III.C.26. Although their status as securities must be taken as true, the basis for this finding is entirely unstated, and by no means obvious. There is no clear factual or legal support for the conclusion that they were securities, and Rose and Leeman could have reasonably

determined, at least based on the record in this proceeding, that they were not securities. Admittedly, the differing opinions Rose and Leeman heard from Schantz, Pauciulo, and Sherman, and the uncertainty their internet research uncovered, suggested that a formal opinion from counsel might have been helpful. But the effort Rose and Leeman did put into researching the notes' status, as documented in the record, was more consistent with negligence than recklessness. And, if he was aware of the issue, Featherstone seemingly relied on Rose and Leeman, the more senior members of Retirement Surety, so his state of mind was even less culpable than theirs.

Third, the Division has not met its burden of proving evidence of recklessness. *See* 5 U.S.C. § 556(d). The Division's motion for summary disposition has no attachments or affidavits, and essentially relies for factual evidence entirely on the Settlement Order. But the Settlement Order is notably vague regarding the individual Respondents' states of mind. The most relevant paragraph, paragraph III.C.27, implies that Respondents were aware that the notes might be securities, and recites certain facts, pertaining principally to Leeman, supporting that implication. That paragraph does not, however, explicitly find that the individual Respondents acted recklessly or otherwise with scienter, and does not mention Featherstone at all. And although the Division submitted additional evidence in its reply, such evidence should have been submitted with the original motion. *See generally* Vakiener Decl. Exs. A-C; *cf. Vais Arms, Inc. v. Vais*, 383 F.3d 287, 292 & n.10 (5th Cir. 2004) (observing that courts normally consider evidence first presented in a reply only if the nonmovant has "an adequate opportunity to respond"). In any event, the additional evidence is not especially persuasive and pertains almost exclusively to Leeman.

On balance, the record does not support a finding that Respondents acted in reckless disregard of a regulatory requirement. I therefore conclude that only first-tier penalties are appropriate.

The public interest factors indicate that maximum penalties are inappropriate

Regardless of tier, penalties must also be in the public interest. In deciding whether a civil penalty is in the public interest, the Commission considers several factors: (1) whether the act or omission involved fraud; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require. 15 U.S.C. §§ 77h-1(g)(2), 78u-2(c); *Thomas C. Gonnella*, Securities Act Release No. 10119, 2016 WL 4233837, at *14 & n.70 (Aug. 10, 2016).

Rose, Featherstone, and Leeman were unjustly enriched and civil penalties will have a deterrent effect. In addition, the fact that low penalties were imposed on other Verto Note brokers in settled proceedings does not require leniency. *See* Resp. Opp. at 8 n.2; *Philip A. Lehman*, Exchange Act Release No. 54660, 2006 WL 3054584, at *9 (Oct. 27, 2006) (refusing comparison to "settled cases whose sanctions may understate the sanctions that would be imposed in litigated cases because settled sanctions reflect pragmatic considerations"); *see also Geiger v. SEC*, 363 F.3d 481, 488 (D.C. Cir. 2004) ("The Commission is not obligated to make its sanctions uniform . . . .").

Yet, on balance, the public-interest factors weigh against a maximum penalty. Respondents did not act with scienter, and even the Division does not suggest that Rose, Featherstone, and Leeman committed fraud. *See* Div. Mot. at 13-14. Although they touted their Christian affiliation to attract investors and advertised the supposed safety of the Verto Notes, there is no record evidence of an affinity fraud or that they knew that the notes were not safe. *See* Settlement Order *Id.* ¶¶ III.A.1-.2, III.C.18-.19. Insofar as they knew of the publicly available terms of Schantz's settlement with the New Jersey Bureau of Securities, Rose and Leeman had some reason to view him as a fair dealer who had previously made the mistake that they wished to avoid. *See Clearing Servs.* Consent Order at 2-4. And Pauciulo also appeared authoritative. *See, e.g.*, Resp. App. at 1002. Rose and Leeman should not have relied entirely on Schantz and Pauciulo, but the record shows why they did.

Turning to whether investors were harmed, it appears that some investors have not received the money owed under the Verto Notes and forbearance agreements. *See, e.g.*, *Schantz* Judgment. But those records also indicate that a settlement has been reached with Schantz to make Verto investors whole. *Id.* at 5-6. And while the individual Respondents' conduct exposed their clients to the risk of potential harm, the Division has submitted no evidence that *Respondents'* clients have suffered actual harm. Nor have Rose, Leeman, and Featherstone committed prior securities violations. They are all far closer to the ends of their careers than the beginnings. *See* Resp. App. at 361, 580, 995.

Taking into account the public interest factors, the Commission has discretion to determine the amount of penalties appropriate within a given tier. *See S.W. Hatfield, CPA*, Exchange Act Release No. 73763, 2014 WL 6850921, at *12 (Dec. 5, 2014). The maximum first-tier penalty for individuals between March 6, 2013, and November 2, 2015, is $7,500, and the maximum penalty for violations that occurred thereafter is $8,458 under Section 8A(g) and $9,239 under Section 21B. 17 C.F.R. § 201.1001;

Adjustments to Civil Monetary Penalty Amounts, 83 Fed. Reg. 1,396, 1,397-98 (Jan. 11, 2018). The Division has not attempted to apportion the individual Respondents' violations to the second period, so the lower penalty cap will apply. *See* Div. Mot. at 12. A separate civil penalty may be imposed for each "act or omission" in violation of the securities laws, so part of the Commission's discretion involves determining what constitutes an "act or omission." *J.S. Oliver Capital Mgmt.*, Securities Act Release No. 10100, 2016 WL 3361166, at *14-15 (June 17, 2016), *pet. filed*, No. 16-72703 (9th Cir. Aug. 15, 2016).

Before considering the individual Respondents' ability to pay, I determine that it is appropriate in this case to impose a single penalty of approximately one-half of the maximum on each Respondent, or $4,000. Imposing a single penalty per Respondent recognizes the reality that although there were multiple statutory violations, they were of a piece. *See, e.g.*, *Anthony Fields, CPA*, Securities Act Release No. 9727, 2015 WL 728005, at *24 n.162 (Feb. 20, 2015) (allowing that all of a respondent's misconduct "'may be considered as one course of action' constituting a single act for purposes of assessing a civil penalty").

Respondents' ability to pay limits the appropriate sanctions against Leeman alone

Under Securities Act Section 8A(g)(3) and Exchange Act Section 21B(d), in any proceeding in which the Commission may impose a civil penalty, a respondent may present evidence of its ability to pay the penalty. 15 U.S.C. §§ 77h-1(g)(3), 78u-2(d). The Commission may, in its discretion, consider such evidence in determining whether a penalty is in the public interest. *Id.* Such evidence may relate to the extent of the respondent's ability to continue in business and the collectability of the penalty, taking into account any other claims of the United States or third parties upon the respondent's assets and the amount of the respondent's assets. *Id.*; *see First Sec. Transfer Sys., Inc.*, 52 S.E.C. 392, 397 (1995). Pursuant to Rule 630(a) of the Commission's Rules of Practice, the Commission also considers evidence of ability to pay as a factor in determining whether to impose disgorgement and interest. 17 C.F.R. § 201.630(a).

Rose, Leeman, and Featherstone have submitted evidence of their current financial circumstances. *See* Resp. App. at 1-995. The Division has contested only the legal consequences of this evidence, not its accuracy. *See* Div. Reply at 6-7; *cf.* Resp. Opp. at 7 (noting that factual disputes regarding ability to pay may prevent summary disposition). Based on the documentation, Rose and Featherstone are both capable of paying the full amount of disgorgement, prejudgment interest, and civil penalties. But

Leeman's financial condition warrants reducing the amount of disgorgement ordered and refraining from imposing prejudgment interest or civil penalties.

Paying the full monetary sanctions will burden Rose and Featherstone. But both plainly can afford to pay them. They have substantial net assets. Resp. App. at 560, 583. Although the majority of their assets are not liquid, they include assets that can be sold or borrowed against. *See, e.g.*, *id.* at 365-66; *id.* at 582. And both of their households have large monthly incomes despite their ages. Rose has a monthly surplus even after a recent change in employment in his household. *Id.* at 372, 580-81. Featherstone too has a significant monthly surplus. *Id.* at 585-87. Between their assets and their cash flow, Rose and Featherstone have the ability to pay either in a lump sum or through a payment plan established in coordination with the Commission.

By contrast, Leeman's position is more precarious despite the benefit he received from brokering Verto Notes. His net worth is not substantial in comparison to his potential liability and his net monthly income is barely positive. *Id.* at 3, 359-60, 362. And—unlike Rose and Featherstone, who are 62 and 70 but in reasonably good heath, *see id.* at 580, 995—Leeman is a 68 year-old with a medical condition that will likely impact his ability to earn income while it increases his monthly expenses. *Id.* at 361; *see id.* at 284-86. I therefore find it appropriate to limit Leeman's disgorgement to $100,000, and to refrain from imposing prejudgment interest or the penalties that would otherwise be appropriate.

Order

It is ORDERED that the Division of Enforcement's motion for summary disposition against Thomas Rose, David Leeman, and David Featherstone is GRANTED.

It is FURTHER ORDERED that, under Section 8A(e) of the Securities Act of 1933 and Sections 21B(e) and 21C(e) of the Securities Exchange Act of 1934, Thomas Rose shall DISGORGE $297,360.00, plus prejudgment interest; David Leeman shall DISGORGE $100,000.00 and pay no prejudgment interest; and David Featherstone shall DISGORGE $120,760.00, plus prejudgment interest. The prejudgment interest owed by Rose and Featherstone shall be calculated from January 1, 2017, to the last day of the month preceding the month in which payment of disgorgement is made. Prejudgment interest shall be calculated at the underpayment rate of interest established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), and shall be compounded quarterly. *See* 17 C.F.R. § 201.600(b).

It is FURTHER ORDERED that, under Section 8A(g) of the Securities Act of 1933 and Section 21B(a)(1)-(2) of the Securities Exchange Act of 1934, Thomas Rose and David Featherstone shall each PAY A CIVIL MONEY PENALTY in the amount of $4,000.00.

Payment of civil penalties, disgorgement, and prejudgment interest shall be made no later than twenty-one days following the day this initial decision becomes final, unless the Commission directs otherwise. Payment shall be made in one of the following ways: (1) transmitted electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payments from a bank account via Pay.gov through the SEC website at http://www.sec.gov/ofm; or (3) by certified check, bank cashier's check, bank money order, or United States postal money order made payable to the Securities and Exchange Commission and hand-delivered or mailed to the following address along with a cover letter identifying the Respondent and Administrative Proceeding No. 3-18061: Enterprise Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Blvd., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This initial decision shall become effective in accordance with and subject to the provisions of Rule 360. *See* 17 C.F.R. § 201.360. Under that rule, a party may file a petition for review of this initial decision within twenty-one days after service of the initial decision. A party may also file a motion to correct a manifest error of fact within ten days of the initial decision, pursuant to Rule 111. *See* 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then a party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact.

The initial decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct a manifest error of fact or the Commission determines on its own initiative to review the initial decision as to a party. If any of these events occurs, the initial decision shall not become final as to that party.

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Cameron Elliot
Administrative Law Judge