Initial Decision Release No. 1392
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
December 20, 2019

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

Jeffrey J. Ansley and Troy (T.J.) Hales, Bell Nunnally & Martin LLP, for Respondents Thomas Rose, David Leeman, and David Featherstone

Before: James E. Grimes, Administrative Law Judge

Summary

In this administrative proceeding, the Securities and Exchange Commission alleged that Respondents David Featherstone, David Leeman, and Thomas Rose sold securities in violation of the registration requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934. The parties agreed to a partial settlement which included findings of fact and a finding of liability on a no-admit, no-deny basis. I partially granted the Division of Enforcement's motion for summary disposition and found that Featherstone, Leeman, and Rose should pay disgorgement and prejudgment interest. This initial decision resolves the remaining issues. I conclude that Featherstone, Leeman, and Rose did not act with scienter, first-tier civil

penalties are in public interest, and the disgorgement to be paid by Featherstone and Leeman but not Rose should be reduced due to a demonstrated inability to pay.

Procedural Background

The Commission initiated this proceeding in July 2017, when it issued an order instituting proceedings alleging that Featherstone, Leeman, and Rose (Respondents), together with Retirement Surety LLC and Crescendo Financial LLC, violated Securities Act Section 5(a) and (c) by selling unregistered securities and Exchange Act Section 15(a)(1) by acting as brokers without registering with the Commission. In November 2017, the Commission entered an order accepting Respondents' settlement offer.[1] The settlement order made findings of fact and determined that they committed the charged violations.

The settlement order also resolved claims against Retirement Surety and Crescendo based on their agreement to each be legally dissolved.[2] As to Featherstone, Leeman, and Rose, the settlement order provided for additional proceedings to resolve whether they should be ordered to pay disgorgement, prejudgment interest, and civil penalties.[3] In these additional proceedings, Respondents cannot contest that they violated Section 5 and Section 15 or the settlement order's factual findings, which must be accepted as true.[4]

Following issuance of the settlement order, the Division moved for summary disposition. A previously assigned administrative law judge granted that motion in April 2018 and issued an initial decision.[5] In August 2018, following the Supreme Court's decision in *Lucia v. SEC*, the Commission remanded all pending administrative proceedings on appeal from this office, including this one; ordered that each proceeding must be reassigned to an administrative law judge who did not previously participate in the matter,

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1 *Retirement Surety LLC*, Securities Act Release No. 10436, 2017 WL 5437486 (Nov. 14, 2017) (Settlement Order).

2 Settlement Order § III.E.

3 *Id.* § IV.

4 *Id.*

5 *Retirement Surety*, Initial Decision Release No. 1250, 2018 WL 1872124 (ALJ Apr. 18, 2018).

unless the parties expressly agreed otherwise; and directed the newly assigned judges to give each respondent the opportunity for a new hearing.[6]

After initial reassignment, this proceeding was reassigned to me in March 2019.[7] The Division filed a new motion for summary disposition. Respondents opposed the motion and asserted inability to pay as an affirmative defense. I granted the Division's motion in part.[8] I determined, based on the violations found in the settlement order, that Featherstone, Leeman, and Rose should disgorge the commissions they received for selling the unregistered securities and that prejudgment interest was appropriate.[9] I concluded, however, that factual disputes prevented me from deciding whether Featherstone, Leeman, and Rose acted with scienter.[10] Because scienter is a factor to be weighed in determining civil penalties and whether disgorgement or penalties should be reduced due to an inability to pay, I was unable to resolve those questions.[11]

I asked the parties to jointly propose a procedure and schedule for resolving the remaining issues, and the parties proposed that I decide the proceeding based on the existing written record, supplemented by additional briefing and evidence, without an in-person hearing. Based on the parties' agreement and the Commission's order on the continuation of proceedings, I adopted this proposal.[12]

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6 *Pending Admin. Proc.*, Securities Act Release No. 10536, 2018 WL 4003609, at *1, *6 (Aug. 22, 2018); *see also Lucia v. SEC*, 138 S. Ct. 2044 (2018).

7 *Retirement Surety*, Admin. Proc. Rulings Release No. 6475, 2019 SEC LEXIS 294 (ALJ Mar. 4, 2019).

8 *Retirement Surety*, Admin. Proc. Rulings Release No. 6602, 2019 SEC LEXIS 1385, at *45 (ALJ June 13, 2019).

9 *Id.* at *27–29.

10 *Id.* at *29–41.

11 *Id.* at *41, *44.

12 *Retirement Surety*, Admin. Proc. Rulings Release No. 6634, 2019 SEC LEXIS 1794 (July 19, 2019); *see* Settlement Order § IV ("[T]he hearing officer may, in his discretion, determine the issues raised in the additional proceedings on the basis of the written record, without a hearing."); *Pending Admin. Proc.*, 2018 WL 4003609, at *1 (ordering administrative law judges to consider the parties' "proposals for the conduct of further proceedings" in remanded proceedings). The parties waived any claim on appeal that

In conducting this proceeding, I gave no weight to the opinions, orders, or rulings of the administrative law judge who presided over this proceeding before the Commission's remand.[13]

Findings of Fact

The findings and conclusions in this initial decision are based on the record and on facts officially noticed.[14] After my summary disposition order, Featherstone, Leeman, and Rose each submitted a new declaration regarding his financial condition in support of the inability-to-pay defense. Otherwise, the factual record is the same as the summary disposition record. For this reason, the factual findings below are largely similar to those made in the order on summary disposition.[15] On summary disposition, however, I reviewed the evidence in light most favorable to Respondents. In this decision, I resolve any factual disputes by a preponderance of the evidence as the standard of proof.[16] In a separate section, I make new findings about Respondents' ability to pay.

Background

Respondents are in their 60s or 70s and at relevant times described themselves as licensed insurance agents.[17] None of them hold securities licenses and none of them has ever been registered as a broker-dealer or associated with a registered broker-dealer.[18]

The unregistered securities at issue in this proceeding were created by William R. Schantz.[19] Schantz was sanctioned and suspended in 2002 by the National Association of Securities Dealers for brokering the sale of

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determining the outcome on the basis of a written record without an in-person hearing was error. *Retirement Surety*, 2019 SEC LEXIS 1794, at *1.

[13] *See Pending Admin. Proc.*, 2018 WL 4003609, at *1.

[14] *See* 17 C.F.R. § 201.323.

[15] *See* 2019 SEC LEXIS 1385, at *6–24 & nn.18–101.

[16] *See John Francis D'Acquisto*, Investment Advisers Act of 1940 Release No. 1696, 1998 WL 34300389, at *2 (Jan. 21, 1998).

[17] Settlement Order ¶¶ 3–5. The Commission's factual findings in Section III of the Settlement Order are cited by paragraph number.

[18] *Id.* ¶¶ 3–5, 29.

[19] *Id.* ¶¶ 6, 12.

unregistered nine-month promissory notes guaranteed by insurance companies without disclosing the sales to the NASD-member firm with which he was associated.[20] In 2006, he entered into a consent order with the New Jersey Bureau of Securities for the same conduct.[21] Schantz agreed to disgorge $7,000 in commissions to New Jersey.[22] Respondents were aware of the consent order.[23] In 2009, Schantz formed Verto Capital Management LLC.[24]

In late 2013, Verto began issuing 7% promissory notes that are central to the findings and charges in the settlement order.[25] From then until November 2015, Verto issued about $12.5 million of these notes.[26]

In May 2017, the Commission filed a civil complaint against Schantz and Verto in the United States District Court for the District of New Jersey.[27] Following settlement, the court entered judgment against Schantz and Verto, permanently enjoining them from violating Securities Act Sections 5 and 17(a) and, after amendment, ordering them to pay about $4.8 million in

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[20] *Id.* ¶ 6.

[21] *Id.* I take official notice of Schantz's consent order with the New Jersey Bureau of Securities. *See Clearing Servs. of Am., Inc.,* No. BOS 1796-02 (N.J. Bureau of Sec. Jan. 18, 2006), http://www.njconsumeraffairs.gov/Actions/20060117_ClearingServicesofAmericaIncschantz.pdf; 17 C.F.R. § 201.323.

[22] Settlement Order ¶ 6.

[23] *Id.* ¶ 27.

[24] *Id.* ¶ 9.

[25] *Id.* ¶¶ 9, 12.

[26] *Id.* ¶12.

[27] *See* Complaint, *SEC v. Schantz*, No. 1:17-cv-03115 (D.N.J. May 4, 2017), ECF No. 1. I take official notice of the district court's docket and its orders and the parties' filings, as reflected in the docket. *See* 17 C.F.R. § 201.323.

disgorgement, interest, and civil penalties.[28] About $1.5 million remains due to 36 investors, 32 of whom were Respondents' clients.[29]

Respondents managed Retirement Surety from 2013 through 2015.[30] It described itself on its website as an organization "comprised of a group of 'state licensed partners,' all from 'career[s] outside of the financial services industry' who provide investment advice for retirement planning."[31] Retirement Surety has never been associated with a registered broker-dealer or registered as a broker-dealer.[32]

Rose and Leeman also managed Crescendo, which was formed in June 2013 to broker the sale of Verto notes.[33] Crescendo's website described its members as "licensed partners" using language almost identical to that found on Retirement Surety's website.[34] It also has never been associated with a registered broker-dealer or registered as a broker-dealer.[35]

Sales of Verto Notes

Turning to the events in this case, Schantz first contacted Leeman sometime in 2012.[36] Rose and Featherstone first met Schantz in late 2012.[37] Schantz proposed to offer "a nine month note product … that caught

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[28] Settlement Agreement, *Schantz* (May 4, 2017), ECF No. 3; Final Judgment as to Defendants William R. Schantz and Verto Capital Management LLC at 1–4, *Schantz* (May 8, 2017), ECF No. 4; *see* Amended Final Judgment as to Defendants William R. Schantz and Verto Capital Management LLC 1, 4, *Schantz* (Feb. 27, 2018), ECF No. 13.

[29] Vakiener Decl. ¶ 14.

[30] Settlement Order ¶ 1.

[31] *Id.* (alteration in original).

[32] *Id.*

[33] *Id.* ¶ 2.

[34] *Id.* (alterations in original).

[35] *Id.*

[36] Vakiener Decl., Ex. D at 106; *see* Resp'ts' App. 1509.

[37] Resp'ts' App. 1506, 1512; *see* Vakiener Decl., Ex. D. at 107.

[Respondents'] eyes, because [they] thought it was not a security."[38] And Respondents knew that if the Verto notes were securities, they "should not be selling" the notes because Respondents held no securities licenses.[39]

Respondents began selling Verto notes in November 2013.[40] In order to satisfy themselves that Verto notes were not securities, they took certain steps, including conferring with Schantz and his attorney, John Pauciulo with the firm Eckert Seamans Cherin & Mellott, LLC, who told Respondents that the nine-month note "wasn't a security because of [certain] exemptions."[41] Before Respondents began selling Verto notes, Schantz told them that Pauciulo opined that the notes were not securities.[42] Rose testified that he, Leeman, and Schantz also had "a couple of phone call conversations" with Pauciulo, and "some" of those calls were before they started selling Verto notes.[43] Respondents and Schantz participated in phone conference calls with Pauciulo, during which Pauciulo told Respondents that the Verto notes were not securities.[44]

As part of their "due diligence outside of the law firm" that Schantz retained—meaning Pauciulo and Eckert Seamans—Respondents performed internet research about what constitutes a security and exemptions from

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38 Vakiener Decl., Ex. D. at 107.

39 Resp'ts' App. 1430; *see* Vakiener Decl., Ex. D at 107.

40 Settlement Order ¶ 27.

41 Vakiener Decl., Ex. D. at 107; *see* Resp'ts' App. 1513. During investigative testimony, Schantz stated, "it's pretty clear. I've read the code" and "it specifically states that notes [that] would mature in nine months or less are not … securities." Resp'ts' App. 1447.

42 Resp'ts' App. 1431. And Leeman testified that he believed Schantz: "most of all, we had the testimony of Mr. Schantz, who we believed would have never engaged in selling" Verto notes "if his attorney had said you better not, it is a security. He wouldn't do that." Vakiener Decl., Ex. E at 106.

43 Vakiener Decl., Ex. D at 137. Leeman testified that they had received Pauciulo's "view" that the Verto notes were not securities before sales started, but he could not recall whether that view was expressed in a phone call or email exchange. Vakiener Decl., Ex. E at 106; *see* Resp'ts' App. 1513.

44 Vakiener Decl., Ex. D at 136–38.

registration, including the nine-month note exemption.[45] Their research led Respondents to conclude that a nine-month note "may or may not be a security" depending on "different criteria."[46] When asked what criteria Respondents found, Rose stated: "One, the fact that it is nine months; two, it said even if it was longer than nine months, as long as the note is backed by assets of a company, then it is not a security."[47] Based on their research, Respondents "felt that [a Verto note] wasn't a security."[48]

Leeman emailed Schantz on November 15, 2013, to say that another individual, Dave Valencia, told Leeman that he (Valencia) would "not participate" because Valencia's attorney believed the Verto notes were securities.[49] Leeman added, however, that his internet research revealed nothing "that would call a 9 month note a security unless the laws are different in California."[50] Schantz responded that "[w]e use very good and expensive counsel to vet these issues and there is no problem at all with a 9 month note. You may be correct that there is something in California …. I would be happy to have [Valencia's] counsel speak to ours …."[51]

On November 19, 2013, Schantz emailed Leeman and attorney Thomas D. Sherman, of Locke Lord LLP, in order to introduce the two to each other.[52] Context shows that Sherman was the attorney who told Valencia that the Verto notes were securities. Schantz said he would be "happy to discuss our 9 month note program" and added that Pauciulo, who "has an extensive

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45 Vakiener Decl., Ex. D at 108; *see id.* at 110 ("[J]ust doing Google searches, right, and trying to find SEC documents. We're obviously not securities licensed, so we wanted to make sure we weren't, you know, doing anything wrong."); Vakiener Decl., Ex. E at 109; Vakiener Decl., Ex. F at 7917.

46 Vakiener Decl., Ex. D at 108, 110.

47 *Id.* at 109.

48 *Id.* at 108.

49 Vakiener Decl., Ex. F at 7917.

50 *Id.*

51 *Id.*

52 Vakiener Decl., Ex. G at 271.

securities background and is an ex investigator for the SEC," was "[o]ur counsel for the note program."[53]

Sherman responded the next morning raising issues relating to whether the Verto notes could qualify for certain registration exemptions.[54] He also noted that California does not have a commercial-paper exemption and asked why the notes would not be securities under California law.[55] Leeman responded that he hoped "it's all OK because I wrote up $75,000 today!"[56] This statement by Leeman is the earliest evidence of when an investor purchased a Verto note brokered by Respondents. Based on a preponderance of the evidence, November 20, 2013, was the first day Respondents sold Verto notes.

The next day, November 21, 2013, Leeman forwarded Sherman's email to Rose.[57] Among other things, Leeman said that if Schantz and Pauciulo convinced Sherman that "it's OK" for them to sell the notes, "we've scored a big win for future people who may question it."[58] He added that he "hope[d] it all works out because I wrote about $85,000 yesterday."[59] There is no evidence that Respondents had additional contact or discussions with Sherman.

At some point before November 21, 2013, Respondents also spoke to a securities attorney in Dallas named David Shelmire.[60] Leeman testified that Respondents spoke to Shelmire before November 21, 2013, about whether Verto notes were securities.[61] And when asked whether Respondents

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53 *Id.*

54 *Id.* at 269–70.

55 *Id.* at 270.

56 *Id.* at 269. He added, "Nice that we have an attorney vetting the company for us on Dave Valencia's nickel!!" *Id.*

57 Vakiener Decl., Ex. H at 31789.

58 *Id.*

59 *Id.*

60 Vakiener Decl., Ex. D at 108–10, Ex. E at 107–08.

61 Vakiener Decl., Ex. E at 107.

"consult[ed] any other attorney about" whether Verto notes were securities, Rose responded that Respondents spoke to Shelmire.[62]

The Division asserts that Respondents did not speak to Shelmire about whether the Verto notes were securities but instead consulted him on other issues.[63] Respondents did not disclose attorney-client communications with Shelmire. For this reason, I will not give any weight to Respondents' consultations with Shelmire in determining Respondents' mental state when selling the Verto notes.

In any event, as noted, Respondents began selling Verto notes in November 2013.[64] Over the next two years, Respondents sold 162 notes to 82 investors.[65] Respondents received a 7% commission for each note they sold, with 5% going to the individual seller and 2% to Crescendo.[66]

Respondents solicited investors, including their insurance clients; gave investors offering materials; advised investors; and monitored and managed investor repayments.[67] Rose and Leeman advertised the notes on two radio networks and directed listeners to Retirement Surety's website.[68] According to the site, a Verto note was "A Nine Month, Short-Term Investment with significantly higher returns than CDs or other safe money investments," and was "200% collateralized" by life settlement policies.[69] Crescendo's website described an investment in the Verto notes as low risk and said the investment was "not a speculative investment influenced by market performance or the economy but rather an investment backed by 200% collateral with a known value."[70]

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62 Vakiener Decl., Ex. D at 108–09.

63 Mot. at 8, 18.

64 Settlement Order ¶¶ 12, 27.

65 *Id.* ¶¶ 12, 20.

66 *Id.* ¶ 21.

67 *Id.* ¶¶ 13–20.

68 *Id.* ¶ 18.

69 *Id.*

70 *Id.* ¶ 19.

Respondents also provided investors with a brochure.[71] In the brochure, Respondents stated that investments were "fully collateralized and secured by a collateral assignment and pledge agreement of the life settlements acquired and owned by Verto."[72] They added that "life settlement assets will have a minimum ratio of 2:1 or 200% (loan to face value) in life settlements acquired and traded."[73] Respondents also stated that the investment was "not … speculative" and "[a]ll the risk of a life settlement maturing at an accurately determined life expectancy is born by the institutions that purchase them from Verto."[74]

In late June 2014, Leeman emailed Schantz to ask about "the difference between" the notes that led to Schantz's consent order "and what we have?"[75] Leeman added that "it looks like" the notes Schantz previously sold "were also 9 month notes."[76]

In early August 2014, Pauciulo responded to Leeman's forwarded email that the law in the area "is complex and can be confusing."[77] He said, however, "We have drafted the documents with the intent to meet the requirements of the 9 month note exemption."[78] Although Pauciulo thought the Commission or a court would agree they are exempt, he wrote that it "would not be feasible" to "provid[e] a formal legal opinion" on the subject.[79] He also offered that they could rely on the exemption in Securities Act "Section 4(2)" and "possibly, Regulation D."[80] Finally, he suggested that rather than accepting commissions,

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71 Vakiener Decl. ¶ 11.

72 Vakiener Decl., Ex. J at 3 (capitalization altered).

73 *Id*. (capitalization altered).

74 *Id*. at 4.

75 Settlement Order ¶ 27.

76 *Id.*

77 Vakiener Decl., Ex. I at 1.

78 *Id*.

79 *Id*.

80 *Id*. The reference to Section 4(2) is presumably a reference to Securities Act Section 4(a)(2), which provides a registration exemption for issuer transactions not involving any public offering. 15 U.S.C. § 77d(a)(2). Regulation D under the Securities Act establishes exemptions for "limited

Respondents "could serve as a purchaser representative and be retained and paid by the purchaser."[81]

Verto was sometimes unable to pay investors under the terms of their notes.[82] When that happened, Respondents negotiated and arranged "forbearance agreements" between Verto and the investors.[83] Respondents received an additional 4% commission for each forbearance agreement.[84]

Respondents received $565,419 in commissions for brokering Verto notes, $89,279 for obtaining signed forbearance agreements, and an additional $29,552 for obtaining second forbearance agreements.[85] In total, this broke down to $297,360 for Rose, $243,435 for Leeman, and $120,760 for Featherstone.[86]

For purposes of this proceeding, it is established that the Verto notes were securities and that no registration exemption applied to them.[87] No registration statement was ever filed for the offer and sale of the Verto notes.[88] Respondents knew that at least five of their investors were unaccredited.[89] Respondents did not provide investors with the financial information required by Securities Act Rule 502(b)(2), and no one ever filed a Form D with the

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offerings" and transactions deemed not to be public offerings. 17 C.F.R. §§ 230.504(a), .506(a).

81 Vakiener Decl., Ex. I at 1.

82 Settlement Order ¶ 22.

83 *Id.* ¶¶ 16, 22.

84 *Id.* ¶ 22.

85 *Id.* ¶ 23.

86 *Id.* ¶ 24.

87 *Id.* ¶¶ 26, 28.

88 *Id.* ¶ 28.

89 *Id.* Rule 506 under Securities Act Regulation D deals with unregistered offerings to accredited investors—those who meet certain income or sophistication requirements found in Rule 501(a). 17 C.F.R. §§ 230.501(a), .506.

Commission stating that Verto had complied with the exemptions in Securities Act Rule 506.[90]

Financial Condition of Respondents

The facts concerning Respondents' financial condition come from the Respondents' statements of financial condition and supporting documentation, which were prepared in May 2017, and supplemented by Respondents' August 2019 declarations.[91]

Featherstone

Featherstone is 72 years old.[92] He is self-employed as a piano tuner and rebuilder, which can be a physically demanding job and becomes more difficult as he ages.[93] A significant portion of his income comes from Social Security benefits.[94] Featherstone provides for two adult dependents who require around-the-clock care.[95] Caring for his dependents reduces the time he has to work, although he relies on a friend to help when he needs to work or run

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[90] Settlement Order ¶ 28. Rule 502(b)(2) governs the information that must be given to investors when securities are sold under Rule 506. 17 C.F.R. § 230.502(b)(2). Issuers that rely on Rule 504 or 506 use Form D to file notice with the Commission of an offering. 17 C.F.R. § 230.503(a).

[91] Pages 1 to 1425 of Respondents' appendix are filed under seal. *Retirement Surety*, Admin. Proc. Rulings Release No. 6526, 2019 SEC LEXIS 665 (ALJ Mar. 28, 2019). For the same reasons, Respondents' supplemental filings, pages 1505 to 1514 of the appendix and accompanying exhibits, will be placed under seal. Because Respondents' ability to pay is one of the core issues in this proceeding, however, I will discuss some high-level details from those materials that do not reveal personally identifiable or otherwise sensitive information. *See* Rules of Practice, 60 Fed. Reg. 32,738, 32,792–93 (June 23, 1995) (comment to adoption of 17 C.F.R. § 201.630(c)).

[92] Resp'ts' App. 1505.

[93] *Id.* at 1506.

[94] *Id.* at 1505.

[95] *Id.* at 1505–06.

errands.[96] Featherstone expects to incur "significant expenses" related to the care of his dependents.[97]

In 2017, Featherstone's monthly household income varied from month to month and was approximately $11,000.[98] His monthly household expenses were about $8,600.[99] Because of the need to devote additional time to the care of his dependents, Featherstone's household income decreased to approximately $4,000 per month as of August 2019.[100] He did not provide an update to his monthly expenses. Featherstone reported assets of about $1,500,000, including a home valued at $300,000, and liabilities of about $140,000, by far the largest of which was his home mortgage, on his 2017 statement of financial condition.[101]

Leeman

Leeman is 70 years old.[102] He is self-employed selling life insurance and a self-published book.[103] The vast majority of his household income comes from his wife, but she is 71 years old and wishes to retire.[104] Leeman has a significant medical condition that requires expensive treatment and hinders his ability to work.[105] Since 2017, Leeman's monthly household income has been approximately $6,300 and his monthly expenses were about $8,000.[106] In

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96 *Id.*

97 *Id.* at 1506.

98 *Id.* at 1015–16.

99 *Id.* at 1016.

100 *Id.* at 1505–06.

101 *Id.* at 1012–13.

102 *Id.* at 6, 1508.

103 *Id.* at 1508.

104 *Id.* at 4–6, 1508.

105 *Id.* at 1508–09.

106 *Id.* at 1508. Leeman's household income was substantially higher in 2016. *Id.* at 5.

2017, his total assets were over $430,000, including a home, and liabilities were about $200,000.[107]

Rose

Rose is 63 years old.[108] He is a self-employed insurance salesperson.[109] His combined household income is about $6,000 per month, the majority of which is Social Security benefits.[110] Rose's monthly expenses are about $9,200.[111] Rose's household income was significantly higher before 2017 due to changes in his wife's employment.[112] Including two homes with a combined value of about $650,000, Rose and his wife have over $1,000,000 in total assets and about $320,000 in total liabilities.[113]

Conclusions of Law

Civil Penalties

I denied the Division's motion for summary disposition with respect to civil money penalties due to material questions of fact regarding whether respondents acted recklessly. Reviewing the record again, I do not find sufficient evidence to conclude that they were reckless. Applying the statutory factors and considering the other sanctions imposed, I find that first-tier civil money penalties are in the public interest.

Legal Standards

In this proceeding, the Commission may impose civil monetary penalties if a respondent has willfully violated a provision of the Securities Act or Exchange Act and the penalty is in the public interest.[114] The settlement order

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[107] *Id.* at 1–3.

[108] *Id.* at 1511.

[109] *Id.*

[110] *Id.*

[111] *Id.* at 1512.

[112] *Id.*

[113] *Id.* at 420–22.

[114] 15 U.S.C. §§ 77h-1(g)(1), 78u-2(a)(1). Under Exchange Act Section 21B(a)(2), the Commission may also impose civil monetary penalties here because this proceeding was instituted as a cease-and-desist proceeding and

conclusively resolves against Respondents the question of whether they violated the Securities Act or Exchange Act and whether they acted willfully.[115] That leaves the public interest and the penalty tier.

In determining whether civil penalties are in the public interest, the Commission considers (1) whether the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the harm to others; (3) any unjust enrichment; (4) the respondent's history of securities-law violations or criminal offenses; (5) the need for deterrence; and (6) such other matters as justice requires.[116] The maximum civil penalty that may be imposed is based on the culpability of the respondent and is divided into three tiers. A first-tier penalty for the period at issue in this proceeding is limited to $7,500 and may be imposed for any violation.[117] A second-tier penalty, which has a maximum of $80,000, may be imposed if the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.[118] And a third-tier penalty, with a maximum of $160,000, may be imposed if the requirements for second-tier penalties are met and the violation resulted in either "substantial losses or

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Respondents violated a provision of the Exchange Act. 15 U.S.C. § 78u-2(a)(2). Section 21B(a)(2) does not explicitly require a finding that a Respondent acted willfully or that the penalty be in the public interest. *Id.*

115 Settlement Order § III.D.

116 15 U.S.C. § 78u-2(c). Although the Securities Act does not contain a statutory list of public-interest factors, the Commission considers the factors listed under the other securities statutes when assessing the public interest under the Securities Act. *See Thomas C. Gonnella*, Securities Act Release No. 10119, 2016 WL 4233837, at *14 & n.70 (Aug. 10, 2016), *pet. argued*, No. 16-3433 (2d Cir. Sept. 9, 2019); *see generally* 15 U.S.C. § 77h-1.

117 15 U.S.C. §§ 77h-1(g)(2)(A), 78u-2(b)(1); 17 C.F.R § 201.1001, tbl.I. Higher maximum penalty amounts apply to conduct occurring after November 2, 2015. *See* Adjustments to Civil Monetary Penalty Amounts, 84 Fed. Reg. 5122 (Feb. 20, 2019). Although the last Verto notes were sold in November 2015, Settlement Order ¶ 12, and Respondents earned commissions on forbearance agreements in 2016, *id.* ¶ 24, the vast majority of commissions were earned before November 2, 2015. Because the Division did not make any argument to the contrary, I will use the maximum civil penalty amounts in effect from March 6, 2013, to November 2, 2015.

118 15 U.S.C. §§ 77h-1(g)(2)(B), 78u-2(b)(2); 17 C.F.R § 201.1001, tbl.I.

created a significant risk of substantial losses to other persons" or "substantial pecuniary gain to the person who committed the act or omission."[119]

There is no allegation that Respondents' conduct involved fraud, deceit, or manipulation. The parties dispute whether Respondents acted in reckless disregard of a regulatory requirement. Recklessness is not a "heightened form of ordinary negligence" but requires "an 'extreme departure from the standards of ordinary care … which presents a danger of misleading buyers … that is … so obvious that the actor must have been aware of it.'"[120] For example, the "'egregious refusal to see the obvious, or to investigate the doubtful' … is strong evidence of recklessness."[121]

Parties' Arguments

The Division argues that third-tier civil penalties should be imposed because Respondents recklessly disregarded the registration requirements of the Securities Act and Exchange Act.[122] In support of this, the Division contends that Respondents harbored concerns that the Verto notes could be securities and were on notice after hearing from Valencia that he would not participate due to his attorney's opinion that the Verto notes were securities.[123] The Division also argues that Respondents could not have reasonably relied on the information they received from Schantz and Pauciulo—who, as Verto's attorney, was not a disinterested party.[124] According to the Division, Respondents began selling the notes before hearing from Pauciulo, and Pauciulo stated that he could not provide a formal legal opinion.[125] The

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119 15 U.S.C. §§ 77h-1(g)(2)(C), 78u-2(b)(3); 17 C.F.R § 201.1001, tbl.I.

120 *SEC v. Steadman*, 967 F.2d 636, 641–42 (D.C. Cir. 1992) (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)).

121 *Bernerd E. Young*, Securities Act Release No. 10060, 2016 WL 1168564, at *17 (Mar. 24, 2016) (quoting *Chill v. General Elec. Co.*, 101 F.3d 263, 269 (2d Cir. 1996)), *argued*, No. 16-1149 (D.C. Cir. Dec. 16, 2019).

122 Div. Supp. Reply at 2

123 *Id.* at 2–3; Settlement Order ¶ 27.

124 Div. Supp. Reply at 3.

125 *Id.*

Division further contends that Respondents' sale of the notes created a substantial risk of loss to investors.[126]

Respondents assert that they acted in good faith. Because they were inexperienced in securities matters, they relied on others, including Schantz and Pauciulo, who repeatedly told them that the Verto notes were not securities.[127]

Recklessness

The evidence does not show that Respondents recklessly disregarded the registration requirements of the securities laws. Respondents knew they could not sell securities.[128] And they were interested in the Verto notes because they believed the notes were not securities under the nine-month exemption.[129] Although Respondents did some research on their own, because they did not have a securities background, they primarily relied on others' advice.[130] In this

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[126] *Id.* at 4–5.

[127] Supp. Resp. at 7.

[128] *See* Vakiener Decl., Ex. D. at 107.

[129] *See id.*

[130] One court has observed that because "securities laws are 'complex and often uncertain'" a "'layman [*i.e.*, a non-lawyer] has no real choice but to rely on counsel.'" *Howard v. SEC*, 376 F.3d 1136, 1147 n.20 (D.C. Cir. 2004) (quoting Douglas W. Hawes & Thomas J. Sherrard, *Reliance on Advice of Counsel as a Defense in Corporate and Securities Cases*, 62 Va. L. Rev. 1, 36 (1976) (alteration in original)).

Although a securities attorney familiar with the history of the nine-month exemption might think otherwise, the statute's plain language could be read to support a blanket exception for all nine-month notes. 15 U.S.C. §§ 77c(a)(3) (listing as exempted securities any note "which has a maturity at the time of issuance of not exceeding nine months"); 78c(a)(10) ("The term 'security' … shall not include … any note … which has a maturity at the time of issuance of not exceeding nine months ….''). *But see Reves v. Ernst & Young*, 494 U.S. 56, 63 (1990) ("[T]he phrase 'any note' should not be interpreted to mean literally 'any note,' but must be understood against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts."); *id.* at 73 (Stevens, J., concurring) (noting that the courts of appeals "have been unanimous in rejecting a literal reading" of the nine-month-note exemption);

proceeding, Respondents did not assert a formal advice of counsel defense, but "reliance on the advice of counsel need not be a formal defense; it is simply evidence of good faith," and therefore "a relevant consideration in evaluating … scienter."[131]

Given Schantz's position and disciplinary background, if Respondents had relied solely on his word that the Verto notes were not securities, their reliance would have been misplaced and they consequently might have been reckless to sell the notes. But the same is not true about Respondents' reliance on Pauciulo. Respondents knew that he was "from a very large and reputable law firm in Philadelphia,"[132] and that he had extensive securities experience.[133] Rose and Leeman communicated with Pauciulo and received his assurance that the Verto notes were exempt before starting sales.[134] When Leeman raised questions about the exemption in 2014, Pauciulo again advised that the notes were created to meet the exemption's requirements.[135] It is true that Pauciulo conditioned his analysis with the statement that "a formal legal opinion" regarding the Verto notes was not "feasible."[136] Although this might have been a red flag to experienced securities practitioners, Respondents were not experienced. And while the Division remarks on Pauciulo's statement that he could not "provid[e] a formal legal opinion," it has neither explained the significance Respondents as laymen should have attached to this qualifier nor denied that Pauciulo was, in fact, an experienced securities attorney.

Respondents were unwise and perhaps overly credulous, but relying on Pauciulo's advice was not an egregious refusal to investigate the doubtful.[137]

Interpretation of Section 3(a)(3), 26 Fed. Reg. 9158, 9159 (Sept. 20, 1961) (explaining the reach of the nine-month exemption).

131 *Howard*, 376 F.3d at 1147.

132 Vakiener Decl., Ex. E. at 105.

133 Vakiener Decl., Ex. G at 271.

134 Vakiener Decl., Ex. D at 136–38; Ex. E at 106; Resp'ts' App. 1513.

135 Vakiener Decl., Ex. I at 1.

136 *Id*.

137 Some securities professionals, including experienced registered representatives, have a duty to investigate "'where there are any unusual factors'" and the failure to do so in the face of an "abundance of red flags" is evidence of extreme recklessness despite the approval of a compliance officer. *See Graham v. SEC*, 222 F.3d 994, 1005–06 (D.C. Cir. 2000) (quoting *Sharon*

Although there were some red flags, the evidence does not show that it was so obvious the notes were securities that Respondents *must* have known it. Respondents, therefore, did not act with scienter when they failed to register as brokers and sold unregistered securities. The first public interest factor weighs in Respondents' favor.

Other Factors

Regarding harm to others, the Verto notes did not perform as advertised, causing some investors to lose money. The fair fund established in *SEC v. Schantz* is evidence of the significant overall harm caused by the Verto notes, and as of April 2019 Schantz still owed $1.5 million to investors under the terms of his judgment.[138] Respondents' conduct contributed to this harm, although their role in selling the notes based on Schantz's assertions was not as significant as Schantz's role in creating the notes and making unlikely assertions about them. Twenty-three investor customers of Leeman and Rose, who invested about $1.65 million or roughly 20% of the investments brokered by Leeman and Rose, submitted declarations stating that they were "happy

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M. Graham, Exchange Act Release No. 40727, 1998 WL 823072, at *6 n.30 (Nov. 30, 1998)). But Respondents were inexperienced and unregistered—a violation of the securities laws for which they are liable. While they perhaps should have known better, in their position not further investigating the notes was not extremely reckless. *Cf. id.* at 1006. Indeed, in another case involving the sale of unregistered securities, the Commission held that consulting with others, including an attorney, "whom [the respondent] reasonably regarded as more sophisticated … than … himself" was a strong mitigating factor that weighed in favor of a minor sanction. *Charles C. Carlson*, Exchange Act Release No. 14246, 1977 SEC LEXIS 162, at *20 (Dec. 12, 1977).

[138] Vakiener Decl. ¶ 14; Amended Final Judgment as to Defendants William R. Schantz and Verto Capital Management LLC, *Schantz* (Feb. 27, 2018), ECF No. 13. Schantz and the Commission have continued to litigate over the unsatisfied balance of the consent judgment. *See* Order, *Schantz* (July 1, 2019), ECF No. 28 (holding Schantz in contempt); Consent Order, *Schantz* (Sept. 23, 2019), ECF No. 45 (appointing an agent to sell a property).

with the services provided."[139] Of those 23 investors, 11 had received a full return of principal and interest.[140]

Respondents received large commissions—7% on the original sales and 4% on the forbearance agreements. These commissions constituted unjust enrichment. On the other hand, Respondents do not have any history of violations of the securities laws or prior disciplinary history. And given Respondents' age, current employment, suspensions from industry association, and cease-and-desist order, the need for specific deterrence is minimal and the need for general deterrence is adequately covered by the other sanctions imposed.

As to "such other matters as justice requires," Respondents' liability hinges on whether the Verto notes were securities. Although Respondents now concede—and the settlement order confirms—that the notes were securities, Respondents were not reckless in determining that the notes were not securities.[141] I cannot ignore, however, the fact that Respondents "held themselves out as financial advisors providing specialized knowledge on investments," when they lacked any specialized knowledge.[142] And although they were aware of Schantz's background, Respondents accepted his unlikely assertions about Verto notes at face value without further investigation and without supporting documentation.[143] They therefore told prospective investors that Verto notes were non-speculative, low risk and "200%

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[139] Resp'ts' App. 1451–60, 63–78, 81–82, 1487–1504; *see* Settlement Order ¶ 24.

[140] Resp'ts' App. at 1451, 1453, 1455, 1457, 1471, 1473, 1477, 1489, 1493, 1495, 1497.

[141] Respondents' situation is similar to that in *Carlson*, where the Commission held that although Carlson sold unregistered securities, his liability was mitigated by the fact that he relied on the advice of others, including an attorney, "whom he reasonably regarded as more sophisticated … than he was." 1977 SEC LEXIS 162, at *20; *see id.* at *20 n.40 (stating that although "those assurances [were] incorrect[,] … we cannot shut our eyes to the fact that some" authoritative sources "appear[ed] to have agreed with … the assurances on which Carlson relied.").

[142] Settlement Order ¶ 25; Vakiener Decl., Ex. E at 112.

[143] Vakiener Decl., Ex. D at 76, 89–90.

collateralized" based only on what Schantz told them.[144] So, while Respondents did not act with scienter in violating Section 5 and Section 15, their actions leave much to be desired.

Conclusion

Because Respondents did not act with scienter, only first-tier civil penalties may be imposed. Respondents' misconduct led to serious harm to investors and Respondents received hundreds of thousands in unjust enrichment. Weighing Respondents' conduct and the other statutory factors, and Respondents' ability to pay, which is addressed below, a civil penalty within the first-tier range is appropriate and in the public interest. I will order each Respondent to pay a $3,750 civil penalty.

Ability to Pay

In determining whether disgorgement, interest, or monetary penalties are in the public interest, the Commission or its administrative law judges may consider evidence concerning ability to pay.[145] Considering this evidence is an exercise of discretion, and even if the Commission considers ability to pay, it "is only one factor … and is not dispositive."[146] Respondents bear the burden of proving their inability to pay.[147]

The Commission has not provided extensive guidance concerning inability to pay, but it has imposed penalties despite a demonstrated inability to pay when the misconduct at issue is "sufficiently egregious."[148] I will apply a two-part inquiry in determining whether to reduce monetary sanctions due to an inability to pay.[149] First, I will consider whether any Respondent has

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144 Settlement Order ¶¶ 18–19; Vakiener Decl., Ex. D at 76, 89–90.

145 17 C.F.R. § 201.630(a); *see* 15 U.S.C. §§ 77h-1(g)(3), 78u-2(d). Because the Division has not disputed Respondents' ability-to-pay evidence, I take it at face value.

146 *Thomas C. Bridge*, Securities Act Release No. 9068, 2009 WL 3100582, at *25 (Sept. 29, 2009), *pet. denied sub nom. Robles v. SEC*, 411 F. App'x 337 (D.C. Cir. 2010).

147 *Philip A. Lehman*, Exchange Act Release No. 54660, 2006 WL 3054584, at *4 & nn.29–30 (Oct. 27, 2006).

148 *Bridge*, 2009 WL 3100582, at *25; *Lehman*, 2006 WL 3054584, at *4.

149 *See Retirement Surety*, 2019 SEC LEXIS 1385, at *42–44.

demonstrated an inability to pay in whole or in part. Second, if a Respondent has demonstrated an inability to pay, I will consider whether I should credit that in view of the seriousness or egregiousness of the violation in relation to the Commission's mission of "'protecting investors[,] … safeguarding the integrity of the markets,'" and "making securities law violations unprofitable."[150]

Featherstone

Although Featherstone reported significant assets on his statement of financial condition, review of that document shows that his net assets are not as significant as they appear.[151] Since he submitted that statement, his income has decreased substantially and he has an additional adult dependent. Featherstone's income is now insufficient to cover his monthly expenses, and his long-term earning potential is low.

I previously determined that Featherstone should disgorge $120,760.[152] While I did not calculate prejudgment interest, it is likely to be significant—more than $13,000.[153] Comparing this amount to Featherstone's current financial condition, he has established an inability to pay the entire amount. Turning to the second part of the inquiry, while the violations are serious,[154]

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[150] *Gordon Brent Pierce*, Securities Act Release No. 9555, 2014 WL 896757, at *19 (Mar. 7, 2014) (quoting *SEC v. Rind*, 991 F.2d 1486, 1491 (9th Cir. 1993)) (describing the Commission's mission in the course of explaining the purpose of disgorgement), *pet. denied*, 786 F.3d 1027 (D.C. Cir. 2015).

[151] In his May 2017 statement of financial condition, Featherstone declared that his net worth exceeded $1 million. Resp'ts' App. at 1012–13. His largest asset, however, was identified as the "Cash Surrender Value of Insurance." *Id.* at 1012. But in his explanation of assets, Featherstone stated that his insurance policies were "beneficial to [his] family as stated in the policy," and "[b]oth are term, not permanent life." *Id.* at 1013. Featherstone's next biggest asset is his home, but it is partially encumbered by a mortgage and is the home for two dependents who depend on him to provide constant care. *Id.* at 1012–13. One of Featherstone's dependents is also the beneficiary of a trust that, in 2017, provided annual income of about $3,000. *Id.* at 1419–20.

[152] *Retirement Surety*, 2019 SEC LEXIS 1385, at *27.

[153] *See id.* at *27 n.106.

[154] The registration requirements in Securities Act Section 5 "are a keystone of the entire system of securities regulation, and set forth basic requirements for the protection of investors." *Sirianni v. SEC*, 677 F.2d 1284, 1289 (9th Cir.

Featherstone's conduct was not egregious. As discussed, he did not act with scienter. It is appropriate to credit his inability to pay.

Because Featherstone's monthly cash flow is negative and not likely to increase in the future, and because of the economic challenges he faces resulting from the fact he must provide long-term, continuous care for two dependents, it is appropriate to discount his disgorgement amount. But because of the importance of Section 5 and Section 15, and because of the manner in which Respondents held themselves out as financial advisors and accepted and repeated Schantz's claims, I cannot waive the entire disgorgement amount. I will discount it by half, for a final disgorgement figure of $60,380, plus prejudgment interest.[155]

Leeman

Leeman reported a net worth of about $240,000, most of which is equity in his home.[156] His monthly household expenses exceed his monthly household income, and this income is likely to decrease in the future considering his significant medical condition and his and his wife's age. I previously determined that Leeman should disgorge $243,435, and prejudgment interest is likely to exceed $26,000.[157] I find that Leeman has established an inability to pay. Leeman did not act with scienter, and his conduct was not otherwise egregious. I will credit his inability to pay.

Leeman's financial condition is precarious and unlikely to improve in the future. Nevertheless, Leeman is not impecunious, and the seriousness of the violations and his behavior requires that some monetary sanction be imposed. Balancing these factors with Leeman's health, income, and expenses, I reduce

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1982). Similarly, the registration requirement in Exchange Act Section 15 "is 'of the utmost importance in effecting the purposes of the Act' because it enables the SEC 'to exercise discipline over those who may engage in the securities business and it establishes necessary standards with respect to training, experience, and records.'" *SEC v. Benger*, 697 F. Supp. 2d 932, 944 (N.D. Ill. 2010) (quoting *Celsion Corp. v. Stearns Mgmt. Corp.*, 157 F. Supp. 2d 942, 947 (N.D. Ill. 2001)).

155 Prejudgment interest will be calculated from January 1, 2017, as Respondents' earned Commissions "through 2016." Settlement Order ¶ 24.

156 Resp'ts' App. at 1–3.

157 *Retirement Surety*, 2019 SEC LEXIS 1385, at *27 & n.106.

the disgorgement amount to $24,343.50, or 10% of the determined total, plus prejudgment interest.

Rose

Rose is the youngest of the Respondents and in the best financial condition. Although he reported that his expenses currently exceed his household income, he has the highest prospects for increasing income in the future. Rose owns two homes with a combined value of about $650,000, he and his wife have over $1,000,000 in total assets and about $320,000 in total liabilities.[158] I previously determined that Rose should disgorge $297,360 and prejudgment interest is likely to exceed $31,000.[159] Comparing this amount to Rose's financial condition, I find that he has not demonstrated an inability to pay.

Although Rose reported negative monthly cash flow, his net worth is significant, and it appears likely that his household income will increase (or his expenses will decrease) in the future. He and his wife have not yet reached retirement age. For these reasons, I find that Rose can pay the amount of the disgorgement ordered, plus prejudgment interest.[160]

Order

Under Rules of Practice 322 and 630(c), I ORDER that pages 1505 to 1514 of Respondents' appendix and accompanying exhibits be maintained under seal.

Under Section 8A(e) of the Securities Act of 1933 and Sections 21B(e) and 21C(e) of the Securities Exchange Act of 1934, David Featherstone must DISGORGE $60,380; David Leeman must DISGORGE $24,343.50; and Thomas Rose must DISGORGE $297,360. Respondents must pay prejudgment interest on the amount of disgorgement imposed. The prejudgment interest owed will 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 will be computed at the underpayment rate of interest established

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158 Resp'ts' App. at 420–22.

159 *Retirement Surety*, 2019 SEC LEXIS 1385, at *27 & n.106.

160 *Cf. Robert L. Burns*, Advisers Act Release No. 3260, 2011 WL 3407859, at *12 (Aug. 5, 2011) (holding that, where a respondent's net worth exceeded the total amount of disgorgement, penalties, and interest, the respondent had not shown an inability to pay).

under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), and compounded quarterly.

Under Section 8A(g) of the Securities Act of 1933 and Section 21B(a)(1)–(2) of the Securities Exchange Act of 1934, David Featherstone, David Leeman, and Thomas Rose must each PAY A CIVIL MONEY PENALTY of $3,750.

Under Rule of Practice 1100, I ORDER that any funds recovered by disgorgement or civil penalties be placed in a fair fund for the benefit of investors harmed by the violations.

Payment of civil money penalties, disgorgement, and interest must be made no later than 21 days following the day this initial decision becomes final, unless the Commission directs otherwise. Payment must 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 alongside 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 must be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This initial decision will become effective in accordance with and subject to the provisions of Rule 360.[161] Under that rule, a party may file a petition for review of this initial decision within 21 days after service of the initial decision. Under Rule of Practice 111, a party may also file a motion to correct a manifest error of fact within ten days of the initial decision.[162] If a motion to correct a manifest error of fact is filed by a party, then a party has 21 days to file a petition for review from the date of the 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

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161 *See* 17 C.F.R. § 201.360.

162 *See* 17 C.F.R. § 201.111.

to a party. If any of these events occur, the initial decision will not become final as to that party.

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James E. Grimes
Administrative Law Judge