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

Administrative Proceedings Rulings
Release No. 6602 / June 13, 2019

Administrative Proceeding
File No. 3-18061

In the Matter of

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

Order Granting Summary Disposition in Part

This is a partially settled proceeding in which Respondents David Featherstone, David Leeman, and Thomas Rose have conceded that they sold unregistered securities and acted as unregistered brokers. The Division of Enforcement moves for summary disposition on the remaining issues: whether Respondents should be ordered to pay disgorgement, prejudgment interest, and civil penalties. Respondents oppose, arguing that questions of material fact remain. For the reasons discussed below, the Division's motion is granted in part and denied in part.

Background

The Securities and Exchange Commission initiated this proceeding in July 2017, when it issued an order instituting proceedings (OIP) alleging that Featherstone, Leeman, and Rose, together with Retirement Surety LLC, and Crescendo Financial LLC,[1] violated Section 5(a) and (c) of the Securities Act of 1933 by selling unregistered securities and Section 15(a)(1) of the Securities Exchange Act of 1934 by acting as brokers without registering with the Commission. In November 2017, the Commission entered an order

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1 Allegations against Retirement Surety and Crescendo Financial have been fully resolved.

accepting Respondents' settlement offer in which they agreed they had committed the charged misconduct.[2]

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

Following issuance of the Order, the Division moved for summary disposition. A previously assigned administrative law judge granted that motion in April 2018 and issued an initial decision.[6] The Commission, however, vacated that initial decision and remanded for a new hearing before a different administrative law judge.[7]

After initial reassignment, this proceeding was reassigned to me in March 2019.[8] The Division filed a new motion for summary disposition. Respondents have opposed, raising inability to pay as a defense.

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2 *See Retirement Surety LLC*, Securities Act Release No. 10436, 2017 WL 5437486 (Nov. 14, 2017) (the Order).

3 Order at 7.

4 *Id.*

5 *Id.*

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

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

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

Discussion

1. Summary disposition standard

Commission Rule of Practice 250(c) governs the Division's motion for summary disposition.[9] The Division's motion must demonstrate, based on "undisputed pleaded facts, declarations, affidavits, deposition transcripts, documentary evidence or facts officially noted[,] … that there is no genuine issue with regard to any material fact and that the movant is entitled to summary disposition as a matter of law."[10] The Order requires me to accept its findings as true.[11] Because I am adjudicating the Division's motion for summary disposition, however, I must construe the facts, whether established in the Order or otherwise, "in the light most favorable to the" Respondents.[12]

2. Statutory scheme

By way of context, selling unregistered securities via interstate commerce is unlawful.[13] And selling any securities, whether registered or not, is also unlawful if the seller has not registered with the Commission as a broker or dealer.[14] By definition, these prohibitions do not apply if the instrument being sold is not a security or is exempted from the requirements of the Securities Act. And a "note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of *not exceeding nine months*," is exempted.[15] The nine-month exemption applies, however, only to "prime quality negotiable

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9 *See* 17 C.F.R. § 201.250(c).

10 *Id.*

11 Order at 7.

12 Amendments to the Commission's Rules of Practice, 81 Fed. Reg. 50,212, 50,224 n.112 (July 29, 2016).

13 15 U.S.C. § 77e(a), (c).

14 15 U.S.C. § 78*o*(a)(1).

15 15 U.S.C. § 77c(a)(3) (emphasis added) (Securities Act nine-month note exemption); *see* 15 U.S.C. § 78c(a)(10) (Exchange Act nine-month exemption); *see also Zeller v. Bogue Elec. Mfg. Corp.*, 476 F.2d 795, 800 & n.7 (2d Cir. 1973) (explaining that these exemptions cover the same ground).

commercial paper" used to fund "current operational business requirements and of a type eligible for discounting by Federal Reserve banks"[16] and not typically sold to "unsophisticated small investors."[17]

3. Facts determined for purposes of this order

According the Order's established facts, Respondents are in their 60s or 70s and at relevant times described themselves as licensed insurance agents.[18] None of them hold securities licenses and none of them has ever been registered as or associated with a registered broker-dealer.[19]

Four entities described below are relevant to this order: Verto Capital Management LLC, Senior Settlements LLC, Retirement Surety LLC, and Crescendo Financial LLC.

Verto was formed in 2009 by William R. Schantz.[20] Schantz was sanctioned and suspended in 2002 by the NASD for brokering 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.[21] In 2006, he entered into a consent order with the New Jersey Bureau of Securities for the same conduct.[22] Schantz agreed to

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16 Interpretation of Section 3(a)(3), 26 Fed. Reg. 9158, 9159 (Sept. 20, 1961); *see SEC v. R.G. Reynolds Enters., Inc.*, 952 F.2d 1125, 1132 (9th Cir. 1991); *Fox v. Dream Tr.*, 743 F. Supp. 2d 389, 401 (D.N.J. 2010).

17 *SEC v. Am. Bd. of Trade, Inc.*, 751 F.2d 529, 539 n.11 (2d Cir. 1984).

18 The Order says that each Respondent "purports to be licensed as an insurance agent in Texas." Order ¶¶ 3–5. The use of the word *purports* might suggest that Respondents were not actually licensed. But I must take the facts in the light most favorable to Respondents and there is no evidence that Respondents were unlicensed. Indeed, Rose and Leeman testified that they each have an insurance license. *See* Vakiener Decl., Ex. D. at 90, Ex. E at 110.

19 Order ¶¶ 3–5, 29.

20 Order ¶ 9.

21 Order ¶ 6.

22 *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

(continued…)

disgorge $7,000 in commissions to New Jersey.[23] Respondents were aware of the consent order.[24]

In late 2013, Verto began issuing 7% promissory notes that are central to the findings and charges in the 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] The same day that the Commission filed the complaint, the parties submitted a settlement agreement, and the court quickly entered judgment against Schantz and Verto, permanently enjoining them from violating Sections 5 and 17(a) of the Securities Act, permanently enjoining Schantz from selling promissory notes, and ordering them to pay over $3.5 million in disgorgement and interest plus a $600,000 civil penalty.[28] After the Commission learned of additional notes, the court entered an amended judgment increasing disgorgement and interest to approximately $4.18 million.[29] About $1.5 million remains due to 36 investors, 32 of whom were Respondents' clients.[30]

Schantz formed Senior Settlements in New Jersey in 1998.[31] It

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/20060117_ClearingServicesofAmericaIncschantz.pdf; 17 C.F.R. §§ 201.250(c), .323.

23 Order ¶ 6.

24 Order ¶ 27.

25 Order ¶¶ 9, 12.

26 Order ¶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. §§ 201.250(c), .323.

28 Settlement Agreement, *Schantz* (May 4, 2017), ECF No. 3; Final Judgment as to Defendants William R. Schantz and Verto Capital Management LLC, *Schantz* (May 8, 2017), ECF No. 4.

29 Amended Final Judgment as to Defendants William R. Schantz and Verto Capital Management LLC, *Schantz* (Feb. 27, 2018), ECF No. 13.

30 Vakiener Decl. ¶ 14.

31 Order ¶ 11.

originates, purchases, and sells life settlements, primarily with life settlement brokers.[32]

Respondents managed Retirement Surety from 2013 through 2015.[33] It described itself on its website as “a ‘practicing Christian 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.”[34] Retirement Surety has never been associated with or registered as a broker-dealer.[35]

Rose and Leeman also managed Crescendo, which was formed in June 2013 to broker the sale of Verto notes.[36] Similar to Retirement Surety, Crescendo’s website described it as “a ‘practicing Christian organization’ comprised of a group of ‘licensed partners,’ all from ‘career[s] outside of the financial services industry’ who sell ‘investments … [that] have placed our clients on a new course to reach their financial goals.’ ”[37] It also has never been associated with or registered as a broker-dealer.[38]

Turning to the events in this case, Schantz first contacted Leeman sometime in 2012.[39] Rose first spoke to Schantz in late 2012 or early 2013.[40] Schantz proposed to offer “a nine month note product … that caught [Respondents’] eyes … because [they] thought it was not a security.”[41] And Respondents knew that if the Verto notes were securities, they “should not be selling” them.[42]

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32 *Id.*

33 Order ¶ 1.

34 *Id.*

35 *Id.*

36 Order ¶ 2.

37 *Id.*

38 *Id.*

39 Vakiener Decl., Ex. D at 106.

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

41 *Id.*

42 Resp’ts’ App. 1430.

As Rose explained, Schantz and his attorney, John Pauciulo with the firm Eckert Seamans, told Respondents that the nine-month note "wasn't a security because of [certain] exemptions."[43] Not being "securities licensed," this information "caught [Respondents'] attention."[44]

Respondents began selling Verto notes in November 2013.[45] In order to satisfy themselves that Verto notes were not securities, they took certain steps, including conferring with Schantz and Pauciulo. Taking the evidence in the light most favorable to Respondents, the current record reflects that *before* Respondents began selling Verto notes, Schantz told them that Pauciulo opined that the notes were not securities.[46] They also had "a couple of phone call conversations" with Pauciulo, and "some" of those calls were before they started selling Verto notes.[47] Respondents and Schantz participated in phone conference calls with Pauciulo, during which Pauciulo told Respondents that the Verto notes were not securities.[48]

Finally, Respondents received an e-mail from Pauciulo containing his explanation of why the notes were not securities.[49] In addition to Pauciulo's "position," Respondents relied on their "study of what constituted a security."[50] According to Leeman, who could not recall whether Respondents "had an actual phone conversation" involving Pauciulo or an "email exchange," Respondents "most of all … had the testimony of Mr. Schantz, who [they] 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."[51]

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

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

45 Order ¶ 27.

46 Resp'ts' App. 1431.

47 Vakiener Decl., Ex. D at 137.

48 *Id*. at 136–38.

49 Vakiener Decl., Ex. I.

50 Vakiener Decl., Ex. E at 105.

51 Vakiener Decl., Ex. E at 106.

As part of their "due diligence outside of the law firm" that Schantz retained—meaning Pauciulo and his firm, Eckert Seamans—Respondents performed internet research "about what is [a] security, what [are the] exemptions, and nine month note[s], [as] an exemption."[52] Their research led Respondents to conclude that a nine-month note "may or may not be a security" depending on "different criteria."[53] 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.[54]

Based on Respondents' research, they "felt that [a Verto note] wasn't a security."[55]

Leeman e-mailed 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.[56] 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."[57] 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 ...."[58]

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52 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.

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

54 *Id.* at 109.

55 *Id.* at 108.

56 Vakiener Decl., Ex. F at 7917.

57 *Id.*

58 *Id.*

On November 19, 2013, Schantz e-mailed Leeman and attorney Thomas D. Sherman, of Locke Lord LLP, in order to introduce the two to each other.[59] 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 securities background and is an ex investigator for the SEC," was "[o]ur counsel for the note program."[60]

Sherman responded the next morning raising issues relating to whether the Verto notes could qualify for certain registration exemptions.[61] He also noted that California does not have a commercial-paper exemption and asked why the notes would not be securities under California law.[62] Leeman responded that he hoped "it's all OK because I wrote up $75,000 today!"[63]

Leeman's statement is the earliest evidence of when Respondents began selling Verto notes. Taking the evidence in the light most favorable to Respondents, I find that for purposes of this order, November 20, 2013, was the first day they sold Verto notes.

The next day, November 21, 2013, Leeman forwarded Sherman's e-mail to Rose.[64] 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."[65] He added that he "hope[d] it all works out because I wrote about $85,000 yesterday."[66] There is no evidence currently in the record to show that Respondents had additional contact or discussions with Sherman.

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[59] Vakiener Decl., Ex. G at 271.

[60] *Id.*

[61] *Id.* at 270.

[62] *Id.*

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

[64] Vakiener Decl., Ex. H at 31789.

[65] *Id.*

[66] *Id.*

At some point before November 21, 2013, Respondents also spoke to a securities attorney in Dallas named David Shelmire.[67] Leeman testified that Respondents spoke to Shelmire before November 21, 2013, about whether Verto notes were securities.[68] And Rose was asked whether Respondents "consult[ed] any other attorney about" whether Verto notes were securities.[69] Rose responded that Respondents spoke to Shelmire.[70]

The Division asserts that Respondents did not speak to Shelmire about whether the Verto notes were securities but instead consulted him on other issues.[71] For the purposes of this order, however, I take the evidence in the light most favorable to Respondents and conclude that they spoke to Shelmire about whether the Verto notes were securities.

Relying on attorney-client privilege, Leeman declined to say what Shelmire told Respondents.[72] Leeman explained, however, that Respondents spoke to Shelmire because they "wanted to give peace of mind to investors that if there ever came the unlikely event that collateral needed to be claimed, we were prepared to help them and that we had an attorney who said this is valid."[73]

In any event, as noted, Respondents began selling Verto notes in November 2013.[74] Over the next two years, Respondents sold 162 notes to 82 investors.[75] Respondents received a seven percent commission for each note they sold, with five percent going to the individual seller and two percent to Crescendo.[76]

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

68 Vakiener Decl., Ex. E at 107.

69 Vakiener Decl., Ex. D at 108–09.

70 *Id.* at 109.

71 Mot. at 8, 18.

72 Vakiener Decl., Ex. E at 107–08.

73 *Id.* at 108.

74 Order ¶ 12, 27.

75 Order ¶ 12, 20.

76 Order ¶ 21.

Respondents solicited investors—including their insurance clients—gave investors offering materials, advised investors, and monitored and managed investor repayments.[77] Rose and Leeman advertised the notes on two Christian radio networks and directed listeners to Retirement Surety's website.[78] 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 were "200% collateralized" by life settlement policies.[79] 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."[80]

Respondents also provided investors with a brochure.[81] 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."[82] 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."[83] Respondents also stated that the investment was "not … speculative" and "All the risk of a life settlement maturing at an accurately determined life expectancy is born by the institutions that purchase them from Verto."[84]

In June 2014, Leeman e-mailed Schantz to ask about "the difference between" the notes that led to Schantz's consent order "and what we have?"[85]

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77 Order ¶¶ 13–16.

78 Order ¶ 18.

79 *Id.*

80 Order ¶ 19.

81 Vakiener Decl. ¶ 11.

82 Vakiener Decl., Ex. J at 3.

83 *Id.*

84 *Id.* at 4.

85 Order ¶ 27.

Leeman added that "it looks like" the notes Schantz previously sold "were also 9 month notes."[86]

Leeman also e-mailed Schantz in August 2014, expressing concern about whether the Verto notes were exempt from registration.[87] Schantz forwarded Leeman's concerns to Pauciulo, who responded that the law in the area "is complex and can be confusing."[88] He said, however, "We have drafted the documents with the intent to meet the requirements of the 9 month note exemption."[89] 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.[90] He also offered that they could rely on the exemption in Securities Act "Section 4(2)" and "possibly … Regulation D."[91] Finally, he suggested that rather than accepting commissions, Respondents "could serve as a purchaser representative and be retained and paid by the purchaser."[92]

Verto was sometimes unable to pay investors under the terms of their notes.[93] When that happened, Respondents negotiated and arranged "forbearance agreements" between Verto and the investors.[94] Respondents received an additional four percent commission for each forbearance agreement.[95]

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86 *Id.*

87 Vakiener Decl., Ex. I at 1.

88 *Id.*

89 *Id.*

90 *Id.*

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

92 Vakiener Decl., Ex. I at 1.

93 Order ¶ 22.

94 Order ¶ 16, 22.

95 Order ¶ 22.

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.[96] In total, this broke down to $297,360 for Rose, $243,435 for Leeman, and $120,760 for Featherstone.[97]

For purposes of this proceeding, it is established that the Verto notes were securities and that no registration exemption applied to them.[98] No registration statement was ever filed for the offer and sale of the Verto notes.[99] Respondents knew that at least five of their investors were unaccredited.[100] 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 Commission stating that Verto had complied with the exemptions in Securities Act Rule 506.[101]

Respondents have submitted evidence about their financial situations that the Division does not dispute. Given my resolution of the Division's motion, there is no need to discuss this evidence.

4. Analysis

The parties' briefing presents three issues for resolution: (1) the amount of disgorgement and interest; (2) the appropriate amount, if any, to impose as a civil penalty; and (3) whether Respondents have shown an inability to pay and if so, whether that inability to pay should reduce Respondents' liability to pay disgorgement or civil penalties. I will take each issue in turn.

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96 Order ¶ 23.

97 Order ¶ 24.

98 Order ¶ 26.

99 Order ¶ 28.

100 Order ¶ 28. 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. 17 C.F.R. § 230.506.

101 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).

4.1. Disgorgement and interest

This issue is straightforward. Section 8A(e) of the Securities Act and Section 21C(e) of the Exchange Act permit the Commission to order disgorgement—including reasonable interest—in cease-and-desist proceedings.[102] Disgorgement is an equitable, discretionary remedy, which is intended to prevent unjust enrichment and to act as a deterrent.[103] To establish the appropriate amount of disgorgement, the Division need only show "a reasonable approximation of profits causally connected to the violation."[104]

Ordinarily, once the Division makes the required showing, the burden shifts to the respondent to show "that the disgorgement figure was not a reasonable approximation."[105] In this case, however, the Order conclusively establishes that 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. In total, Rose received $297,360, Leeman received $243,435, and Featherstone received $120,760. Respondents must therefore disgorge these amounts plus prejudgment interest determined according to Rule 600 of the Rules of

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[102] 15 U.S.C. §§ 77h-1(e), 78u(e).

[103] *See* 15 U.S.C. §§ 77h-1(e) (providing that the Commission "may" order disgorgement), 78u-3(e) (same); *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989) ("Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws."). The Supreme Court's decision in *Kokesh v. SEC*, 137 S. Ct. 1635, 1643 (2017), holding that disgorgement is a penalty for statute of limitations purposes, did not change the fact that disgorgement is "primarily an equitable remedy 'designed to deprive a wrongdoer of his unjust enrichment.'" *SEC v. Analytica Bio-Energy Corp.*, 317 F. Supp. 3d 574, 580 (D.D.C. 2018) (quoting *First City Fin.*, 890 F.2d at 1230).

[104] *First City Fin.*, 890 F.2d at 1231; *Allstate Ins. Co. v. Receivable Fin. Co.*, 501 F.3d 398, 413 (5th Cir. 2007); *see Montford & Co. v. SEC*, 793 F.3d 76, 83–84 (D.C. Cir. 2015) ("[T]he touchstone of a disgorgement calculation is identifying a causal link between the illegal activity and the profit sought to be disgorged." (quoting *SEC v. UNIOIL*, 951 F.2d 1304, 1306 (D.C. Cir. 1991) (Edwards, J., concurring))); *cf. Swann v. Charlotte-Mecklenburg Bd. of Ed.*, 402 U.S. 1, 15 (1971) ("[B]readth and flexibility are inherent in equitable remedies.").

[105] *First City Fin.*, 890 F.2d at 1232.

Practice.[106] Because all of Respondents' commissions resulted from violations of Securities Act Section 5 and Exchange Act Section 15, all of their commissions are causally related to the conceded securities violations at issue in this proceeding. All of their commissions are therefore subject to disgorgement.[107]

Respondents argue that disgorgement should be reduced by the amount they paid in taxes on their commissions.[108] The Commission, however, does not credit taxes paid against disgorgement.[109]

Respondents argue that the forbearance agreements are not securities and thus commissions received for those agreements should not figure in the disgorgement calculus.[110] But the agreements allowed Verto to defer making the very payments that induced investors to invest. And the need to enter forbearance agreements only arose because of the initial unregistered sales of the Verto notes. The forbearance agreements and commissions Respondents received for them are causally related to Respondents' securities violations.

The Division's motion is granted as to disgorgement and interest.

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[106] 17 C.F.R. § 201.600. *See Terence Michael Coxon*, Exchange Act Release No. 48385, 2003 WL 21991359, at *14 (Aug. 21, 2003) ("[E]xcept in the most unique and compelling circumstances, prejudgment interest should be awarded on disgorgement, among other things, in order to deny a wrongdoer the equivalent of an interest free loan from the wrongdoer's victims."), *aff'd*, 137 F. App'x 975 (9th Cir. 2005). The Division has provided prejudgment interest calculations through the second quarter of 2019. *See* Vakiener Decl., Exs. A-C. While I accept these calculations—$31,845.54 for Rose; $26,070.48 for Leeman; and $12,932.72 for Featherstone—as accurate, because this order does not conclude this proceeding, these numbers will be out of date by the time a final decision is issued.

[107] *Cf. optionsXpress*, Exchange Act Release No. 78621, 2016 WL 4413227, at *36 (Aug. 18, 2016) (finding that commissions earned represented "an appropriate disgorgement amount").

[108] Opp'n at 15–16.

[109] *See optionsXpress*, 2016 WL 4413227, at *36 & n.133; *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 WL 627346, at *19 (Feb. 13, 2015); *cf. SEC v. Merch. Capital, LLC*, 486 F. App'x 93, 96 (11th Cir. 2012) ("reject[ing] the argument that the district court was required" in calculating disgorgement "to take into account the amount of income taxes paid").

[110] Opp'n at 16–17.

4.2. Civil penalties

This proceeding was instituted under Securities Act Section 8A and Exchange Act Section 15(b).[111] In proceedings instituted under Securities Act Section 8A and Exchange Act Sections 15(b), the Commission may impose civil monetary penalties if such penalties are in the public interest and the respondent has willfully violated any provision of or rule under the Securities Act.[112] Exchange Act Section 15(b) also permits imposition of penalties for willful violations of the Exchange Act.[113]

These statutes set out a three-tiered system, based on increasing degrees of culpability, for determining the maximum civil penalty for each securities violation. For the time period at issue, the maximum first-, second-, and

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[111] OIP at 1. Although the proceeding was also instituted under Section 9(b) of the Investment Company Act of 1940, *id.*, the Order omitted any reference to the Investment Company Act.

[112] 15 U.S.C. §§ 77h-1(g)(1), 78u-2(a)(1).

[113] 15 U.S.C. § 78u-2(a)(1). This proceeding was also instituted under Exchange Act Section 21C. OIP at 1. Monetary penalties in proceedings initiated under Section 21C may be imposed based simply on the determination that a violation occurred. 15 U.S.C. § 78u-2(a)(2). This fact is of no consequence here. As discussed below, although a minimum penalty may be imposed based simply on the determination that a violation occurred, *see* 15 U.S.C. § 78u-2(b)(1), the higher penalties sought by the Division must be based on the determination that Respondents deliberately or recklessly disregarded a regulatory requirement. *See* 15 U.S.C. § 78u-2(b)(2), (3), (c)(1).

Additionally, although the Exchange Act contains a list of public interest factors, 15 U.S.C. § 78u-2(c), the Commission is not statutorily required in cease-and-desist proceedings instituted under Section 21C to weigh the public interest before imposing monetary sanctions. *Compare* 15 U.S.C. § 78u-2(a)(1), *with* 15 U.S.C. § 78u-2(a)(2). Nonetheless, because the statutory factors found in subsection (c) provide an appropriate standard, and it would be incongruent if the Commission were to approve monetary sanctions in cease-and-desist proceedings without any analysis of the particular circumstances presented, I would rely on those factors in deciding whether a monetary penalty is appropriate, even if this proceeding were instituted solely under Section 21C. *See Laccetti v. SEC*, 885 F.3d 724, 725 (D.C. Cir. 2018) ("[T]he arbitrary and capricious standard requires that an agency's action be reasonable and reasonably explained."); *Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012) ("[T]he SEC must provide some meaningful explanation for imposing sanctions.").

third-tier penalty for each violation for a natural person is $7,500, $80,000 and $160,000, respectively.[114] First-tier penalties may be imposed based simply on the fact of a violation.[115] Second-tier penalties may be imposed if the violation involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.[116] And third-tier penalties may be imposed if the requirements for second-tier are met *and* the violation resulted in either

> substantial losses or created a significant risk of substantial losses to other persons; or
>
> substantial pecuniary gain to the person who committed the act or omission.[117]

The Division argues that, as a matter of law, Respondents are deserving of third-tier penalties.[118] To get to the second-tier, the Division asserts that Respondents recklessly disregarded the regulatory requirement "that only licensed securities brokers sell securities."[119] And in support of increasing the penalty to the third-tier, the Division argues that "Respondents' conduct also created a risk of substantial losses to investors who purchased the Verto Notes."[120]

The Division asserts that Respondents' conduct was egregious—Respondents sold several million dollars of unregistered securities, earned hundreds of thousands of dollars of commissions without being registered as

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114 17 C.F.R § 201.1001, tbl.I.

115 15 U.S.C. §§ 77h-1(g)(2)(A), 78u-2(b)(1).

116 15 U.S.C. §§ 77h-1(g)(2)(B), 78u-2(b)(2).

117 15 U.S.C. §§ 77h-1(g)(2)(C), 78u-2(b)(3).

118 Mot. at 18–24.

119 *Id*. at 18.

120 *Id*. at 20. The Division also asserts that "[i]nvestors in the Verto Notes … incur[red] substantial losses." *Id*. But the cited support for this assertion, footnote 11 in the Division's memorandum, merely contains citation to Schantz's 2006 consent order. I thus evaluate the Division's position under the creation-of-substantial-risk prong of the analysis, not the other prong that requires causing an actual loss.

brokers, and violated the law over a period of years.[121] It also argues that Respondents "knowingly assumed the risk that the Verto Notes were securities" but failed to consult their own attorney about that risk.[122] And, the Division argues, Respondents expressed concerns about the notes before and after they began selling and were aware of Schantz's regulatory history.[123] As to the substantial risk Respondents allegedly created, the Division points to assertions about Verto notes on Retirement Surety's and Crescendo's websites and the fact Respondents "held themselves out as financial advisors providing specialized knowledge on investments."[124]

Respondents counter that only first-tier penalties are appropriate.[125] Noting the absence of fraud allegations, they argue that they acted in good faith, having been duly diligent in seeking to determine whether the Verto notes were securities.[126] And Respondents have no disciplinary history.[127] Respondents also put the blame on Schantz, whom they note has been ordered to repay substantial sums to investors.[128] They also offer declarations from 23 investors who are happy with the services Respondents provided.[129] Many of them have received the principal and interest to which they are entitled. Respondents also dispute that they acted recklessly, noting their efforts to ascertain whether the notes were securities.[130]

Exchange Act Section 21B(c) provides a non-exhaustive list of six factors to consider in evaluating the public interest.[131] The Commission applies these

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[121] Mot. at 18.

[122] *Id.*

[123] *Id.* at 19.

[124] *Id.* at 6, 20; *see* Order ¶ 25.

[125] Opp'n at 8–14.

[126] *Id.* at 10–13.

[127] *Id.* at 10.

[128] *Id.* at 10–11, 13.

[129] Resp'ts' App. 1451-1504.

[130] Opp'n at 12–13.

[131] 15 U.S.C. § 78u-2(c). As to the threshold public-interest inquiry, the Division argues that I should weigh the factors described in *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 386 (S.D.N.Y. 2007), which are derived

(continued…)

factors in cases brought under the Exchange Act, as well as in cases brought under Securities Act Section 8A, even though the Securities Act does not contain a statutory list of factors.[132]

The first statutory public-interest factor and the second-tier penalty inquiry ask the same question: whether the misconduct at issue involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.[133] The parties focus on whether Respondents recklessly disregarded a regulatory requirement.[134]

Some of Respondents' actions seem potentially reckless. They portrayed themselves as "'state licensed partners' … from 'career[s] outside of the financial services industry' who provide investment advice for retirement planning."[135] But their "states license[s]" were as insurance agents, not as investment advisers or brokers. And, as Respondents testified, they do not hold any securities licenses.[136] They also accepted Schantz's assertions about the risks and returns of the Verto notes at face value without further investigation and without supporting documentation.[137] And Respondents were aware of Schantz's consent order.[138]

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from a consent judgment discussed in *SEC v. Coates*, 137 F. Supp. 2d 413, 429 (S.D.N.Y. 2001). *See* Mot. at 17. These are not, however, the factors that apply in this proceeding. *See Thomas C. Gonnella*, Securities Act Release No. 10119, 2016 WL 4233837, at *14 & n.70 (Aug. 10, 2016) (weighing the factors found in Section 21B(c) in a case in which penalties were authorized under Securities Act Section 8A and Exchange Act Section 21B).

132 *See Gonnella*, 2016 WL 4233837, at *14 n.70. The statutory factors, not the public-interest factors described in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), apply to the determination of whether the public interest weighs in favor of civil monetary penalties. *See Jay T. Comeaux*, Securities Act Release No. 9633, 2014 WL 4160054, at *5 (Aug. 21, 2014).

133 *See* 15 U.S.C. 78u-2(b)(2), (c)(1).

134 Mot. at 18; Opp'n at 11–12.

135 Order ¶ 1; *see* Order ¶ 2.

136 Ex. D at 107, 110; Ex. E. at 112.

137 Ex. D at 76, 89. The Division points to Respondents' website assertions about Verto notes. Mot. at 20. I agree that the assertions appear unlikely to be accurate. But the Division has presented no evidence that they are false.

(continued…)

But it is not clear that these actions, assuming they amount to recklessness, are what led to Respondents' violations. Respondents' liability under both Section 5 and Section 15 entirely depended on whether the Verto notes were securities or were exempted. They received assurances from Schantz and Pauciulo. They described Pauciulo as being "from a very large and reputable law firm in Philadelphia,"[139] and Schantz said he was "very good and expensive counsel."[140] It is true that Pauciulo was not their attorney, but viewing the evidence and reasonable inferences in Respondents' favor, it is not possible to say they were reckless as a matter of law by relying on his experience and assurances.

Respondents also rely on having "talk[ed] to their own counsel" before selling the Verto notes.[141] But the Division points out that Rose and Leeman invoked attorney-client privilege when asked what Shelmire told them.[142] Respondents cannot, in opposing the Division's motion, rely on the fact they spoke to Shelmire while asserting privilege over the contents of those conversations.[143] For this reason, I have given Respondents' communications with Shelmire no weight in deciding this motion. If, during further proceedings, Respondents wish to rely on the fact that they consulted with Shelmire as part of their defense, they must disclose that fact to the Division. This will necessarily entail waiving any claim of privilege Respondents might otherwise assert with respect to their communications with Shelmire.[144]

Given the current stage of this proceeding, I do not have a basis to conclude the assertions are inaccurate.

138 Order ¶ 27.

139 Ex. E. at 105.

140 Ex. F at 1.

141 Opp'n at 13.

142 Mot. at 8; Reply at 4–5.

143 *In re Grand Jury Proceedings*, 219 F.2d 175, 182 (2d Cir. 2000) ("[A] party cannot partially disclose privileged communications or affirmatively rely on privileged communications to support its claim or defense and then shield the underlying communications from scrutiny by the opposing party.").

144 *See John Doe Co. v. United States*, 350 F.3d 299, 306 (2d Cir. 2003), as amended (Nov. 25, 2003) (addressing "the type of unfairness to [an] adversary that results in litigation circumstances when a party uses an assertion of fact to influence the decisionmaker while denying its adversary

(continued…)

The Division, however, notes that "Respondents continued to harbor concerns" in summer 2014 "that the Verto Notes might be securities."[145] This is true, but the fact they did not heed those concerns does not necessarily mean they were reckless. Indeed Respondents raised their concerns and Pauciulo sought to allay them when he assured Respondents that although the law "is complex and can be confusing," the Verto notes were "drafted … with the intent to meet the requirements of the 9 month note exemption."[146] And although Pauciulo declined to provide "a formal legal opinion" on the issue, he offered that there were other ways in which the notes could be exempt from registration.[147] Taking the evidence in the light most favorable to Respondents, I cannot say that they acted recklessly, as a matter of law, by relying on Pauciulo's opinion.

Material factual questions therefore remain at issue regarding whether Respondents acted recklessly. The Division's motion, as it relates to civil monetary penalties, is denied.

4.3. Inability to pay

By statute, a respondent subject to a possible civil monetary penalty may present evidence of his ability to pay the penalty and the Commission may, in its discretion, consider that evidence in assessing whether the public interest supports imposing a penalty.[148] The Commission has implemented these statutes in Rule of Practice 630, subsection (a) of which provides that "[t]he Commission may, in its discretion, or the hearing officer may, in his or her discretion, consider evidence concerning ability to pay in determining

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access to privileged material potentially capable of rebutting the assertion"); *see also Howard Brett Berger*, Exchange Act Release No. 58950, 2008 WL 4899010, at *11 n.65 (Nov. 14, 2008) (explaining that "attorney-client privilege 'cannot at once be used as a shield and a sword'"). The Division asserts that Respondents have not waived attorney-client privilege as to Shelmire. Reply at 5.

145 Mot. at 19.

146 Ex. I at 1.

147 *Id.* By *formal legal opinion*, Pauciulo may have meant a written letter explaining his opinion. But regardless of whether he would agree to put his opinion in a letter, he had already told Respondents that the Verto notes were not securities. Ex. D. at 107, 136–38.

148 15 U.S.C. §§ 77h-1(g)(3), 78u-2(d).

whether disgorgement, interest or a penalty is in the public interest."[149] The Commission has explained that inability to pay "is only one factor that informs [the] determination" of penalties and disgorgement "and is not dispositive."[150] Respondents bear the burden to show inability to pay.[151]

Although the Commission has not had occasion to provide specific guidance about how to evaluate whether a respondent has shown an inability to pay, it has repeatedly held that it has the discretion not to waive disgorgement or penalties "when the [relevant] misconduct is *sufficiently* egregious."[152] Giving effect to this language means that a respondent whose misconduct is particularly unscrupulous will not fare well when seeking to reduce his or her monetary liability based on an inability to pay. But if a respondent has shown an inability to pay and his or her misconduct is not egregious enough, or not egregious at all, then an administrative law judge may exercise his or her discretion to reduce disgorgement or a penalty.

Cases involving insufficiently egregious conduct will thus require a two-part inquiry. First, an administrative law judge must determine whether the respondent has the ability to pay the imposed disgorgement and penalties. This necessarily involves a comparison of the amounts imposed against the respondent's income, assets, liabilities, and any respondent-specific factors that might bear on his or her ability to pay. If the respondent fails to show an inability to pay, the inquiry ends.

If the respondent shows an inability to pay, whether in whole or in part, the second step involves assessing whether to credit that inability. The Commission has not explained how to undertake this assessment but remembering the Commission's focus on the egregiousness of the misconduct involved, the assessment must involve weighing the seriousness or egregiousness of the violation in relation to the Commission's core mission of

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[149] 17 C.F.R. § 201.630(a).

[150] *Thomas C. Bridge*, Securities Act Release No. 9068, 2009 WL 3100582, at *25 (Sept. 29, 2009).

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

[152] *See Gregory O. Trautman*, Exchange Act Release No. 61167A, 2009 WL 6761741, at *24 (Dec. 15, 2009) (emphasis added) (declining to reduce a penalty in light of the egregiousness of respondent's actions); *Lehman*, 2006 WL 3054584, at *4.

"'protecting investors[,] … safeguarding the integrity of the markets,'" and "making securities law violations unprofitable."[153]

Considering the above, it is apparent that material facts remain at issue regarding Respondents' ability to pay. First, the unresolved dispute about whether Respondents acted recklessly will inform whether their conduct was egregious. And without knowing whether or how much they may be ordered to pay in civil monetary penalties, it is not possible to assess whether they have the ability to pay.

Conclusion

The Division's motion for summary disposition is granted in relation to disgorgement and interest. Whether monetary penalties will be imposed and, if so, in what amounts, will be determined in further proceedings. Whether the amount of disgorgement or penalties will be reduced based on Respondents' alleged inability to pay will also be determined in further proceedings.

Within 14 days, the parties should confer and submit a joint proposal for the further conduct of this proceeding. The parties' proposal should address whether Respondents intend to rely on the advice Shelmire gave them.

James E. Grimes
Administrative Law Judge

[153] *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)).