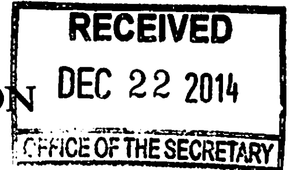
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



Administrative Proceeding
File No. 3-15943

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In the Matter of

DAVID J. MONTANINO,

Respondent.

---X

THE DIVISION OF ENFORCEMENT'S POST-HEARING MEMORANDUM OF LAW

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Pursuant to Commission Rule of Practice 340, the Division of Enforcement (the "Division") respectfully submits this memorandum of law following the hearing against Respondent David J. Montanino ("Montanino").

PRELIMINARY STATEMENT

Montanino defrauded at least four investors in three different schemes spread over six years. A practiced prevaricator who admits he has lied for money, Montanino lied to investors to sell them investments he hoped to profit from. He lied about his experience, the exclusivity of his advisory services, and the investments' risks and returns, among other things. He also misappropriated investment funds. When investors eventually raised concerns, Montanino concealed the truth with obfuscation and more lies. Montanino's fraud cost investors over $474,000.

Montanino peddled two investments overseen by his long-time business partner, Timothy Sullivan ("Sullivan"): American Private Equity, LLC ("American Equity"), a private equity fund, and American Private Fund I, LP ("American Fund"), a hedge fund. From the beginning, Montanino knew that Sullivan was reckless and had run into trouble with securities regulators. But Montanino wanted a piece of Sullivan's flashy lifestyle — with expensive homes and luxury cars — for himself. Montanino pushed the investments in the hopes that Sullivan would keep his promise to pay Montanino handsomely. By the time Sullivan died of [redacted], Montanino had received over $89,000 for his role in the scheme.

Montanino began his fraud in 2005, when he induced Sharon Jones ("Jones") to invest $25,000 — a fifth of her retirement savings — in American Equity. He wove tales about how much money he managed, the exclusivity of his services, and his own (fictional) investment in American Equity to close the deal.

Montanino then lied about his background to get a job at Fidelity Investments. When that job ended and Montanino's job prospects remained dim, he re-joined Sullivan. Sullivan offered to let him manage American Fund and promised to pay Montanino well. In early 2010, Montanino persuaded Susie Yoo ("Yoo") — a former Fidelity customer and friend whose husband was Montanino's veterinarian — to invest $299,000, over a third of her retirement savings, in American Fund. Montanino again lied about how much money he managed and the exclusivity of his services and promised to personally manage her investment. He also concealed the investment's true nature, including that he would invest her money in a hedge fund, that Sullivan controlled the fund, and that the fund could use risky margin trading. Sullivan soon ran American Fund into the ground, before he could pay Montanino.

Even after this debacle, Montanino partnered with Sullivan again to re-start Calibourne Capital Management, LLC ("Calibourne"), a failed investment advisory firm they had abandoned years before. They decided that American Equity would own half of Calibourne. To raise investor funds for American Equity, Montanino drafted a marketing presentation that materially misrepresented his background. Without any legitimate basis, the presentation also projected an enormous, seven- to

fourteen-fold return for American Equity investors. In compensation, Montanino received over $65,000 from American Equity. As investor funds dried up, Montanino and Sullivan convinced William Pankey ("Pankey"), who had already invested $600,000 in American Equity, to invest another $100,000. They told him his investment would be used solely to pay signing bonuses to Calibourne's newly-hired investment advisers. Instead, Montanino took $11,000 of Pankey's investment for himself, and Sullivan used the rest for other purposes. Calibourne never hired any advisers.

Montanino's egregious pattern of intentional fraud violated anti-fraud provisions of the securities laws. Public interest warrants the most severe sanctions. Montanino knowingly defrauded investors of at least $474,000 to feed his own greed. Instead of accepting responsibility, his hearing testimony defied credibility and contradicted his prior sworn statements in regulatory filings. If the Court does not permanently bar Montanino from the entire securities industry and order him to cease and desist, Montanino will find a way to swindle more investors. The Court should also order Montanino to disgorge his ill-gotten gains plus prejudgment interest to deprive Montanino of the fruits of his fraud. Finally, the Court should order Montanino to pay the maximum civil penalty for each violation. Heavy sanctions will deter would-be fraudsters, particularly when Montanino has not been criminally charged.

STATEMENT OF FACTS

I. MONTANINO WORKS WITH SULLIVAN FOR YEARS.

In about 1997, Montanino met Sullivan when both worked for the same securities firm, the Boston Group. (*Compare* DE 9A at 6 *with* DE 10 at 5; Tr. 1402 (Montanino).)[1] From then until early 2003, they worked together for three more securities firms, including a private equity firm, Imagine Venture Capital, LLC ("Imagine"). (Tr. 1126–28 (Montanino); DE 9A at 6.) Sullivan and Philip Redden ("Redden") controlled Imagine. (DE 129B at 7.) While Montanino worked at Imagine, Wisconsin securities regulators sanctioned Sullivan, Redden, and the firm for securities fraud and for employing an unlicensed sales agent. (DE 129B at 83–91.) As he later admitted to Yoo and Tilem, Montanino knew that Sullivan had had regulatory problems.[2] (Tr. 430–31 (Yoo); DE 90; Tr. 1360 (Tilem).)

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[1] Citations to "DE ___" and "R___" are references, respectively, to the admitted Division's exhibits and Respondent's exhibits. Page number citations to Division exhibits refer to the page numbers the Division stamped at the bottom of each page, unless an exhibit contains no such stamps. Citations to "Tr. __ (_____)" refer to the hearing transcript, its page number, and, if otherwise unclear from the context, the testifying witness's last name in parentheses.

[2] Montanino now denies any prior knowledge of Sullivan's regulatory problems. (Tr. 1129.) He also now minimizes his role at Imagine by contradicting his prior sworn statements. In April 2005, Montanino signed and filed a sworn Form U4 with a self-regulatory organization. (DE 9A at 10, 12; Tr. 893–94 (Baier).) He swore or affirmed that he had worked at Imagine (abbreviated "IVC" on the form) from January 1999 to March 2003 and that his "Position" at Imagine was "Sales." (DE 9A at 6.) Montanino understood at the time that false or misleading statements on the form could subject him to "criminal penalties." (DE 9A at 10.) *Cont'd…*

II. MONTANINO FORMS CALIBOURNE WITH SULLIVAN'S HELP.

After leaving Imagine in March 2003, Montanino worked at Fisher Investments for about eleven months and then became unemployed for at least four months. (DE 9A at 6.) In September 2004, Montanino began working as a registered representative at Torrey Pines Securities, Inc. ("Torrey Pines"), a brokerage firm. (*Id.*) While at Torrey Pines, Montanino teamed up with Sullivan and Redden again. In March 2005, Montanino formed Calibourne. (DE 138 ¶A1; Tr. 1101–02 (Montanino).) On April 1, 2005, Sullivan and Redden formed American Equity, a private equity firm. (DE 136 at 4.) American Equity then invested $30,000 in Calibourne in return for an ownership interest of between 10% and 25% of Calibourne. (Tr. 1403 (Montanino); DE 3 at 20–22.) Montanino was admittedly never an owner, investor, or partner of American Equity. (Tr. 1121.)

On April 12, 2005, Montanino applied to register Calibourne as a California investment adviser. (DE 3.) Montanino's plan was "to work at Torrey Pines to build up a client base and then be able to transition a client base over to Calibourne."

Montanino now contends that he misrepresented the amount of time he had worked at Imagine. (Tr. 1127–28 ("Q. Now, you spent about four years in Imagine Venture Capital; is that right, sir? A. That's not correct.... I misrepresented that on my résumé.... I believe I was there a couple of years, two years maybe.").) He also now denies that he played any significant role in sales at Imagine. (Tr. 1128 ("Q. And you were involved in sales there? A. Not necessarily. I was more of an office manager."); Tr. 1401 ("A very small percentage of my overall duties while working with Imagine...were focused on sales.").)

(Tr. 1403 (Montanino).) He did not tell Torrey Pines of his plan. (Tr. 1622 (Montanino).)

III. MONTANINO DEFRAUDS JONES.

A. Montanino Cold-Calls Jones.

In approximately April 2005, Montanino cold-called Jones and told her he was a wealth manager at Torrey Pines looking for clients. (Tr. 21 (Jones); DE 101A at 2.) Montanino told her he usually handled only portfolios worth at least $500,000. (DE 101A at 2.) Jones told him she had only about $125,000 to invest. (*Id.*) Montanino nevertheless arranged to meet Jones to talk to her about opening an account. (*Id.*; Tr. 22 (Jones).) At the time, Jones did not know what a private equity fund was and had never invested in one. (Tr. 19–20 (Jones).)

In approximately May 2005, Montanino met with Jones. (Tr. 22–23 (Jones); DE 101A at 2.) She told him that her investment goal was to save for retirement and retire in ten to fifteen years. (Tr. 23–24 (Jones).) Montanino told her that he could help her open a Torrey Pines account and make investments. (*Id.*) Montanino mentioned that he eventually planned to leave Torrey Pines to start his own company and planned to name it Calibourne. (Tr. 23–24 (Jones).) Montanino made clear that Calibourne had no clients and no revenue and was a future plan. (Tr. 24, 111–12 (Jones); Tr. 1153 (Montanino).) Jones promptly opened a Torrey Pines account and transferred to it all $125,000 of her retirement savings. (Tr. 25–27 (Jones).)

B. Montanino Deceives Jones Into Investing One-Fifth of Her Retirement Savings in American Equity.

Montanino later called Jones and told her that, of her $125,000 at Torrey Pines, he had invested $100,000 in mutual funds. (Tr. 26–27 (Jones).) He urged her to invest the remaining $25,000 in American Equity. (*Id.*) He told her that this would be an opportunity to make a private equity investment "that could make a lot of profit," which would ordinarily require an initial investment significantly larger than Jones could make. (Tr. 28–29 (Jones).) He "positioned [the investment] as something that might be appropriate for her" even though he "had some reservations...because she did have lower assets." (Tr. 1406, 1408 (Montanino).) He assured her that American Equity was a "really good investment" and that he knew Redden, who was an expert in private equity. (Tr. 28 (Jones).) He also told her that private equity was a risky investment that would take years to mature. (Tr. 31–32 (Jones).)

To lessen her concern about the risks, Montanino told Jones that he had an investment in American Equity. (Tr. 32, 54–55, 79–80 (Jones).) Jones found this important, because "if he had a personal investment in the company...he must have a certain amount of faith in its ability to succeed." (Tr. 32–33, 72 (Jones).).

Montanino never told Jones that he was working for American Equity, that American Equity owned part of Calibourne, or that the two firms had a business relationship. (Tr. 33–34 (Jones).) This information would have mattered to Jones in deciding whether to invest, because she would have questioned Montanino's loyalties,

objectivity, and motives and had no desire to invest her retirement savings in a start-up firm. (Tr. 33–35 (Jones).)

When Jones decided to invest in American Equity, Montanino told her that Torrey Pines did not handle private equity investments and that Jones would have to transfer her funds to a self-directed retirement account with Pensco Trust Company ("Pensco"). (Tr. 36, 38 (Jones).) Montanino sent Jones the necessary forms. (*Id.*) On June 1, 2005, Jones signed a document authorizing Torrey Pines to transfer $25,000 to her new Pensco account. (DE 107A at 1; Tr. 38 (Jones).)

On June 3, 2005 — the same day Pensco received Jones' signed authorization — Montanino resigned from Torrey Pines. (DE 107A; DE 11D at 1–2.) He did not tell Jones. (Tr. 39–40 (Jones).)

A few weeks later, Pensco transferred $24,800 of Jones's funds to American Equity's bank account. (DE 107C at 3; DE 107D; DE 107E.) By then, Calibourne was a "dead idea." (Tr. 1404, 1619–20 (Montanino).) It never obtained clients or managed money. (Tr. 1115 (Montanino).)

C. Montanino and Sullivan Quarrel.

In 2005, as Montanino admits, he and Sullivan "butted heads…for...different reasons." (Tr. 1404 (Montanino).) For example, Montanino loaned his car to Sullivan. (Tr. 1404 (Montanino); DE 90 at 1; Tr. 1352–54 (Tilem) (authenticating DE 90).) Without Montanino's permission, Sullivan lent the car to someone who drove it while drunk, had an accident, and then abandoned the car. (*Id.*) This incident "really

aggravated" Montanino. (Tr. 1404 (Montanino).) Around the same time, Sullivan told Montanino that American Equity did not want to move forward with Calibourne. (Tr. 1407 (Montanino).)

D. Torrey Pines Informs Jones That It Did Not Authorize Her American Equity Investment.

In about September 2005, Jones learned from a Torrey Pines employee that Montanino had left the firm. (Tr. at 39–40 (Jones).) Jones then asked her new Torrey Pines account representatives why Montanino had left, and they told her it was confidential. (Tr. 41–43 (Jones).) She asked where Montanino had gone, and they told her they did not know. (*Id.*)

Her new account representatives also told Jones that her investment in American Equity "was probably gone" and that they would not have authorized it. (Tr. 43–45 (Jones).) Jones was surprised. (*Id.*) She would have been reluctant to make the investment if she had known Torrey Pines had not authorized it. (Tr. 45–46 (Jones).)

IV. MONTANINO LIES TO GET A JOB AT FIDELITY.

A. Fidelity Is a Prominent Financial Services Firm.

Fidelity is one of the largest United States mutual fund companies. (DE 121 at 2.) At all relevant times, Fidelity has had a registered brokerage division and a separate registered investment adviser division. (Tr. 131–33 (Whatley).) Fidelity brokers open accounts and sell Fidelity's products and services. (*Id.*) Fidelity investment advisers

have discretion over clients' accounts: clients turn over management of their investments to advisers in return for a fee. (Tr. 133–34 (Whatley).)

B. Montanino Lies to Fidelity About Calibourne and Torrey Pines.

On August 25, 2005, just a few months after leaving Torrey Pines, Montanino signed, certified, and submitted a job application to Fidelity. (Tr. 1090 (Montanino); DE 110; DE 11D at 1–2.) By signing it, Montanino certified that the information on his application form and all his other application materials was "accurate and complete in all respects." (DE 110 at 2, 7.) The application required Montanino to disclose "all employment for the past ten years, including self-employment, summer, part time, and part or full-time military service." (DE 110 at 4.)

On his application, Montanino portrayed Calibourne as a successful endeavor that had paid him an annual salary of $50,000 the first year and $125,000 the second year. (DE 110 at 4.) But Montanino admittedly never earned any money at Calibourne, which had no clients and no assets under management. (Tr. 1115–16.) Montanino admits that he also intentionally failed to disclose his prior employment at Torrey Pines on his application. (Tr. 1098–99, 1100, 1110–13.)

On the resume he submitted to Fidelity with his job application, Montanino similarly lied about his accomplishments at Calibourne. (Tr. 1119 (Montanino).) He claimed that he had "[r]aised in excess of $15 million in new money from high net-worth investors" at Calibourne. (DE 175 at 2; Tr. 1117 (Montanino).) In fact, he had

never raised any money from investors for Calibourne. (Tr. 1115, 1117–19 (Montanino).)

As Montanino concedes, he deliberately falsified his job application and his resume for one reason: so that Fidelity would hire him. (Tr. 1117–19 ("Q. So you lied on your application and on your resume, sir? A. I did. Q. To get a job there? A. I've testified to that, yes.").) Montanino knew that, if he told Fidelity the truth, he would not get the job. (Tr. 1114 (Montanino).)

C. Montanino Joins Fidelity's Brokerage Division.

In the fall of 2005, Fidelity's brokerage division opened a new investor center in Santa Monica, California. (Tr. 131–33, 139–40 (Whatley).) Before it opened, Anne Whatley ("Whatley"), a vice president and branch manager of the new office, began hiring employees. (Tr. 137, 140 (Whatley).) She did not recruit Montanino for a position. (Tr. 192 (Whatley).) She learned from Fidelity's staffing department that Montanino had submitted an application and was a "viable candidate." (Tr. 147–48 (Whatley).)

In approximately September 2005, after reviewing his resume and interviewing him, Whatley hired Montanino as a financial planning consultant in Fidelity's brokerage division. (Tr. 131–32, 152–53, 155, 161–63 (Whatley); DE 175 at 1, 2–3.) Whatley directly supervised Montanino during his three years at Fidelity. (Tr. 162–63 (Whatley); Tr. 1133 (Montanino).)

Montanino's responsibilities included opening new customer accounts and recommending and explaining Fidelity's mutual funds and other products to customers. (Tr. 141–42, 164–73 (Whatley).) To do so, Fidelity required Montanino to consult customers using Fidelity's suite of computerized "guidance tools." (Tr. 164–73 (Whatley).) Customers could enter the required information into the tools themselves or provide Montanino with the required information to enter into the software. (*Id.*) The guidance programs then told Montanino which products and services to explain and recommend to the customer.[3] (Tr. 171 (Whatley).) If a customer wanted professional account management, Fidelity required Montanino to refer the customer to Fidelity's investment adviser division. (Tr. 180–82 (Whatley).)

During his first two years at Fidelity, Montanino was not responsible for any particular group of customers and had no "book of business." (Tr. 162, 163–64, 173–74 (Whatley).) In his last year at Fidelity, Montanino participated in a pilot program in which Fidelity assigned him a group of customers to assist. (Tr. 162, 163–64, 173–74, 175–77 (Whatley).) His role did not otherwise change, and he was still required to use the same software guidance tools to recommend products to customers. (*Id.*)

Montanino never managed customers' investments or assets at Fidelity. (Tr. 174, 178 (Whatley).) He never held discretion over client accounts. (*Id.*; Tr. 1133

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[3] Montanino was allowed to offer a few Fidelity products without the guidance tools: target-date retirement mutual funds that automatically adjusted their investment allocations as an investor neared retirement age, insurance products, and charitable-purpose products. (Tr. 171–73 (Whatley).)

(Montanino).) He never had authority to recommend individual stocks to customers. (Tr. 174; 178 (Whatley); Tr. 1133 (Montanino).)

Nor did Montanino ever handle a book of business worth $1 billion. (Tr. 178–80, 193–94 (Whatley).) At most, customers to whom Montanino provided account services — without managing their accounts — held about $400 to $500 million in assets at Fidelity. (R102 at 2–3; Tr. 174, 178, 195–96 (Whatley).)

D. Montanino Routinely Ensured that Fidelity Customers Received Fund Prospectuses.

Montanino conducted over 1700 customer consultations while at Fidelity. (Tr. 1164 (Montanino).) He admittedly opened thousands of customer accounts and sold tens of millions of dollars of Fidelity products and services. (Tr. 1167, 1400.) As a licensed, registered representative of the firm, Montanino routinely signed account opening documents in which customers acknowledged that they had received and read a prospectus for a Fidelity fund or annuity before investing in it.[4] (DE 119 at 9, 16–17; Tr. 1161, 1167–68, 1170, 1172–74 (Montanino).)

V. MONTANINO CONTINUES TO LIE TO JONES ABOUT HER AMERICAN EQUITY INVESTMENT.

A. Jones Finds Montanino, But He Continues to Lie to Her.

In early 2006, Jones tracked Montanino down at Fidelity and called him. (Tr. 50–52 (Jones).) She asked him why he had left Torrey Pines. (Tr. 52 (Jones).)

[4] Montanino nonetheless claims that he never provided prospectuses to customers and that "there was something maybe in the customer agreement that said they could receive [the prospectus] after" they had invested. (Tr. 1175–76.)

Montanino claimed that he had left to "pursue Calibourne," that it had been more difficult than he had imagined, and that he had therefore gotten a job at Fidelity. (Tr. 52–53 (Jones).) In reality, Calibourne was already a "dead idea" when Montanino left Torrey Pines and he needed "other alternatives for [his] career." (Tr. 1404, 1619–20 (Montanino); DE 107A; DE 11D at 1–2.)

Jones told Montanino that her new Torrey Pines representatives had advised her that her American Equity investment had not been authorized and was "worthless." (Tr. 53 (Jones).) Montanino assured her that they were wrong and that it was a good investment. (Tr. 53–54 (Jones).) Montanino still did not reveal that he had not invested in American Equity. (Tr. 54–55 (Jones).) Trusting Montanino, Jones asked him to help her transfer her other investments from Torrey Pines to Fidelity, and he did. (DE 101B; Tr. 54–58 (Jones).)

In approximately August 2006, Sullivan sent Jones a letter about American Equity. (Tr. 58–59 (Jones).) Jones had never heard of Sullivan and asked Montanino who Sullivan was. (Tr. 58–59, 65–66 (Jones).) Montanino claimed that he was "not well acquainted with" Sullivan. (Tr. 66 (Jones).)

In October 2007, Jones received an American Equity Partnership Form 1065 Schedule K-1 ("K-1") for 2006, which listed her 4% partnership interest in American Equity based on her $25,000 investment. (DE 107G; Tr. 63–64 (Jones).) The K-1 showed that Jones's investment had decreased in value by more than half. (DE 107G.)

Believing that Montanino was also an investor in American Equity, Jones called him and asked whether he had also received a K-1. (Tr. 64–65 (Jones).) Montanino said he had not, but in a way that gave Jones no reason to doubt he had invested in American Equity. (Tr. 66–68 (Jones).)

B. Jones Learns From Sullivan That Montanino Lied to Her About His Role at American Equity.

In November 2007, Jones called Sullivan to find out why her American Equity investment had "lost so much value." (Tr. 68–69 (Jones).) Sullivan said the investment would not show a profit until the assets were sold years later and that the K-1 "really didn't reflect" the investment's actual value. (Tr. 69–70 (Jones).)

Jones mentioned that Montanino had suggested the investment to her because he had also invested in American Equity. (Tr. 71 (Jones).) Sullivan replied that Montanino "isn't an investor, he is an employee of our company." (*Id.*) Surprised, Jones asked Sullivan to redeem her investment. (Tr. 71–72 (Jones).) He told her she "stood to gain a lot of money" by keeping her money invested in American Equity, urged her to reconsider, and assured her he would redeem her investment if she eventually wanted it back. (*Id.*)

Jones never spoke with Montanino again. (Tr. 73 (Jones).) She felt "he had been dishonest" and "questioned his motives" for recommending the investment. (Tr. 73–74 (Jones).)

C. American Equity Refuses To Return Jones's Money, and Her Investment Soon Becomes Worthless.

On March 18, 2008, Jones sent Sullivan a letter asking him for a full redemption. (DE 101C; Tr. 75 (Jones).) She wrote:

> I have become more and more uncomfortable about the fact that David Montanino was, according to you, an 'employee' of yours at the time that he recommended this investment to me. Mr. Montanino told me, when he recommended the investment and again in October, 2007, that he was and is an investor in American Private Equity, not an employee of your company.

(DE 101C.) Sullivan then called Jones and told her that "the company was not in a position" to redeem her investment. (Tr. 76 (Jones); DE 101D.) By October 2008, Jones' $25,000 American Equity investment was worthless.[5] (Tr. at 88–90 (Jones); DE 107H; DE 107I; DE 107J.)

VI. MONTANINO DEFRAUDS YOO.

A. Montanino Helps Yoo with Her Fidelity Accounts.

In April 2006, Montanino met Yoo when she walked into the Fidelity investor center where he worked. (Tr. 260 (Yoo); Tr. 1131–32 (Montanino).) That day, Montanino helped Yoo open a Fidelity retirement account for her and her husband. (Tr. 261–62 (Yoo).) Montanino later helped Yoo move her and her husband's entire retirement savings, totaling about $800,000, to Fidelity. (Tr. 262–64 (Yoo).)

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[5] Since then, Jones has received only $3,000 of her investment back through a separate regulatory action not involving Montanino. (Tr. 91 (Jones).)

Yoo's husband, Dr. Henry Yoo ("Dr. Yoo"), was a veterinarian who owned a veterinary clinic. (Tr. 256 (Yoo).) Yoo managed the clinic and its "business side." (Tr. 256, 591–92 (Yoo).) Yoo also handled her and her husband's personal investments. (Tr. 534 (Yoo).) Montanino soon began taking his two dogs to Dr. Yoo for veterinary care. (Tr. 264–65 (Yoo); Tr. 1132 (Montanino).)

From 2006 to 2008, Yoo continued to consult with Montanino about her and her husband's Fidelity investments. (Tr. 266–68 (Yoo); DE 1 at 7; Tr. 1178–80 (Montanino) (authenticating DE 1).) Yoo and Montanino became friends and socialized. (Tr. 264–65, 439 (Yoo); Tr. 1137, 1226–27 (Montanino).)

B. Montanino Hopes to Get Rich by Re-Joining Sullivan.

On October 3, 2008, Montanino resigned from Fidelity without telling Yoo. (DE 126; Tr. 269 (Yoo).) He remained unemployed until at least November 2009.[6] (DE 9C.) Although he spoke to Whatley about re-joining Fidelity, she told him he would not be a viable candidate "[b]ased on the circumstances that led to his resignation." (Tr. 187–88 (Whatley).)

In late 2009, Sullivan invited Montanino to his house. (Tr. 1409, 1629–30 (Montanino).) Since 2005, Sullivan had acquired a California house worth about $5 to

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[6] According to the sworn Form U4 he signed and filed on July 22, 2010, Montanino was unemployed between October 2008 and April 2010. (DE 9C at 1, 7, 12, 14.) Montanino now claims that he spent about eight months during that time selling reverse mortgages for Genworth Financial. (Tr. 1134–35, 1629.)

$10 million, a beach home in Florida, and a new Audi and had just spent $100,000 or $150,000 on an Aston Martin. (Tr. 1409, 1629–31 (Montanino).)

In late November 2009, Sullivan offered Montanino a job recruiting advisers from other investment firms who could "bring[ ] money to American Private Equity." (Tr. 1135, 1401, 1409, 1629–30, 1632 (Montanino).) Montanino took the job because Sullivan's lavish lifestyle was "attractive" to Montanino, who "wanted to be a part of" it. (Tr. 1409, 1631–32 (Montanino).)

About a week later, Montanino complained to Sullivan that "it wasn't going to work out." (Tr. 1409 (Montanino).) Sullivan then tasked Montanino with writing marketing materials for Sullivan's new hedge fund, American Fund. (Tr. 1409–10 (Montanino).) Montanino did so, and Sullivan paid him about $11,000 for it. (*Id.*)

Sullivan next asked Montanino whether he wanted to manage American Fund. (Tr. 1410–11 (Montanino).) Although Montanino had no hedge fund experience, he jumped at the opportunity. (Tr. 1215, 1410–11 (Montanino).) Sullivan told Montanino that he could manage American Fund and that, if it did well, Sullivan "would take care of" Montanino financially. (Tr. 1411–12, 1632–33 (Montanino).) Sullivan asked Montanino if he could bring any customers into the hedge fund.[7] (*Id.*)

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[7] Montanino claims he told Sullivan that he "wasn't comfortable" with asking former Fidelity customers to invest in American Fund. (Tr. 1410–11.)

When Montanino joined American Fund, he had at least some experience with margin trading.[8] Indeed, he had told Fidelity in 2005 that he had "significant (over one year) trading experience" with margin.[9] (DE 175 at 6–7; Tr. 1641–43 (Montanino).)

C. Montanino Deceives Yoo.

In January 2010, Montanino visited the Yoos' clinic to have his dog treated for an infection. (Tr. 269–70 (Yoo); Tr. 1135–36 (Montanino).) Montanino told Yoo about his new job with American Equity and gave her his American Equity business card. (Tr. 271–74 (Yoo); DE 19A.) Montanino told Yoo he managed money for a lot of clients, that the minimum investment was $1 million, and that some clients had entrusted him with managing $7 to $8 million. (Tr. 271–72, 275 (Yoo).) Yoo was impressed. (*Id.*) In reality, American Fund had no investors, Montanino managed no American Equity assets, and he had no experience with hedge funds. (DE 181A at 1; Tr. 964–68 (Sacco); Tr. 1215, 1409–11, 1412–13 (Montanino).)

In January and February 2010, Montanino met Yoo at the clinic again several times. (Tr. 272, 274–75 (Yoo); Tr. 1413, 1417 (Montanino).) Yoo told Montanino that she did not know how to pick stocks and asked if he could help her. (Tr. 275 (Yoo).) She and Montanino discussed the possibility that he would manage about $300,000 of

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[8] A customer trades on margin (or uses leverage) when he borrows against securities in his brokerage account to purchase additional securities. (Tr. 632 (Monaco).)

[9] He now claims that this representation to Fidelity was inaccurate and that he had traded in margin in his personal account only a few times. (Tr. 1641–44, 1661.)

her and her husband's retirement savings, which they held at Fidelity. (Tr. 275–76, 430 (Yoo).) Montanino claimed he did not manage investments under $1 million but said he would make an exception for Yoo and manage her account without management fees, because she was a friend. (Tr. 276–77 (Yoo); Tr. 1138 (Montanino); R67.) Montanino told her he would charge only a 10% performance fee on the profits. (Tr. 277–78 (Yoo); Tr. 1416–17, 1633 (Montanino).)

Montanino did not tell Yoo that she would be investing in a hedge fund. (Tr. 280–82, 295, 296–97 (Yoo).) Instead, he led her to believe that her funds would be invested and held in her own account. (*Id.*) Yoo would not have made the investment if she had known she would be investing in a hedge fund. (*Id.*)

Before Yoo entrusted her savings to Montanino, she sought and obtained Montanino's oral assurance that he would personally manage her money. (Tr. 1138 (Montanino); Tr. 278–80 (Yoo).) Montanino understood Yoo sought investments that bore moderate to low risk. (Tr. 1177 (Montanino); Tr. 282–83 (Yoo).) But Montanino failed to inform Yoo that her investment would be subject to margin trading. (Tr. 1138–39 (Montanino); Tr. 282 (Yoo).)

D. Montanino Does Not Give the Yoos American Fund's Offering Memorandum.

1. *The Offering Memorandum Discloses the Investment's Nature and Risks.*

Montanino admits that he read at least the "pertinent points" of the American Fund's Confidential Offering Circular ("Offering Memorandum"), including the first

fifteen pages, before the Yoos invested. (Tr. 1156, 1158–59; DE 46.) On the first ten pages, the Offering Memorandum's summary section disclosed that (1) Sullivan managed the fund's general partner; (2) Series B fund investors (limited partners) would not receive any return on their investment until the Series A investors had received a 6% annual return; (3) an investment in the fund involved "significant risks"; (4) the general partner of the fund could use leverage — that is, margin — as it deemed appropriate; and (5) the fund could invest in any type of investment or investment strategy, including real estate, art, and illiquid asset classes. (DE 46 at 6, 7, 8–9, 12.) Montanino also admits that he knew Sullivan — not Montanino — controlled the American Fund and that the Yoos' money would be locked up for two years. (Tr. 1479.)

The Offering Memorandum included an investor subscription agreement as an attachment. (DE 46 at 101–11.) The subscription agreement required each investor or subscriber to make certain "representations, warranties and agreements" by signing. (*Id.* at 101, 111.) The subscriber had to "acknowledge[ ] receipt of the Offering Circular" and affirm that she had "carefully reviewed the Offering Circular." (*Id.* at 103.) The subscriber also had to affirm that she had "consulted with" her own legal and financial advisers about "the merits and risks of an investment." (*Id.* at 104.) The subscriber had to further affirm that she had been able to question American Fund's general partner and obtain answers about the investment's terms. (*Id.* at 106.) The subscription agreement's signature page contained the following bold, underlined

language: "**<u>By its signature below, the undersigned specifically acknowledges and affirms its representations made herein.</u>**" (DE 46 at 111.)

2. *Montanino Does Not Give the Yoos the Offering Memorandum.*

Montanino admittedly knew that the American Fund's investors were supposed to receive the Offering Memorandum before they invested. (Tr. 1183.) He also admittedly understood that the blank "Name of Offeree" line on the memorandum's cover page was supposed to be filled in with the investor's name. (Tr. 1184; DE 46 at 1.)

Yet Montanino did not give the Yoos the Offering Memorandum before they invested. (Tr. 400–01 (Yoo).) Montanino admits there is no documentary evidence that he did so. (Tr. 1181–82.) He never mailed, e-mailed, or faxed it to the Yoos. (*Id.*) Nor did he obtain a copy of the Offering Memorandum from them with their names written on the cover page. (Tr. 1184 (Montanino).)

Before the Yoos invested, Montanino gave them only one or two documents about American Equity or American Fund: a color document with Montanino's biography and the American Private Funds: Stock Market Outlook and Economic Analysis for 2010. (Tr. 284–89 (Yoo); DE 19B.)

On February 26, 2010, Montanino went to the Yoos' veterinary clinic to obtain their signatures on the investment paperwork. (Tr. 289–90 (Yoo).) Montanino admits that he had detached the Offering Memorandum and the subscription agreement from the two signature pages beforehand and brought the Yoos only the signature

pages. (Tr. 1451 (Montanino); Tr. 289, 290–91, 585, 589 (Yoo); DE 20 at 1–2.) These were the signature pages to the Offering Memorandum's subscription agreement. (*Compare* DE 20 at 1–2 *with* DE 46 at 111–12.) Unlike the genuine subscription agreement's signature pages, these two signature pages omitted the original bold, underlined text informing investors that they were affirming the representations in the subscription agreement. (*Compare* DE 20 at 1–2 *with* DE 46 at 111.)

When Montanino gave the Yoos the two pages, the second page had already been filled in and the letter "B" had been circled to indicate a Series B interest.[10] (Tr. 293, 295–96 (Yoo); DE 20 at 2.) Yoo did not know what a "series" of interests meant, and Montanino did not tell her. (Tr. 296 (Yoo).) Yoo and her husband signed the first signature page. (DE 20 at 1; Tr. 292–93 (Yoo).)

3. *The Yoos Invest $299,000 Through Montanino.*

Later on February 26, 2010, Yoo transferred $299,000 of her and her husband's retirement savings from Fidelity to a bank account in American Fund's name. (Tr. 297–98 (Yoo); Tr. 1139, 1203 (Montanino); DE 20 at 3; DE 181A at 1; Tr. 966 (Sacco).) On March 1, 2010, American Fund wired $298,700 of this amount to its new, empty brokerage account at Lime Brokerage, LLC ("Lime"). (DE 181A at 1; Tr. 966–68 (Sacco).) For the next fifteen days, Yoo was the only investor in American Fund. (DE 181A at 1–2; Tr. 964–65 (Sacco).)

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[10] Montanino concedes that the Yoos did not fill in the second page. (Tr. 1673–74.)

E. Montanino Hides Key Facts About Yoo's Investment From Her.

As Montanino admits, Sullivan did not formally authorize Montanino to trade in American Fund's brokerage account until March 19, 2010 — three weeks after the Yoos invested. (Tr. 1204–05 (Montanino); DE 14B-7 at 12; Tr. 649–50, 651, 652–53 (Monaco).) Twenty-five days later, on April 13, 2010, Sullivan de-authorized Montanino from the American Fund account. (Tr. 1485–86 (Montanino); DE 36; Tr. 693–95 (Monaco).)

From March 19 through April 13, 2010, Montanino received eleven emails from Lime that alerted him to a margin call or risk call in American Fund's brokerage account. (Tr. 654–93 (Monaco); Tr. 1204–24 (Montanino); DE 25; DE 26–DE 33; DE 34A; DE 34B.) He received the first risk call email on March 19, the day he received trading authorization, and the last margin call email on April 13, the day he lost trading authorization. (DE 25; DE 34B.)

On March 24, 2010, four days after Montanino received trading authorization, Lime informed Montanino that the American Fund had a margin call for $186,100. (Tr. 1217–18 (Montanino); DE 31.) Lime instructed Montanino and Sullivan that they "must either wire in funds equal to or greater than the call or trade out of it by double the amount of the call" in two days. (DE 31.) At the time, Montanino admittedly knew that American Fund had received only about $500,000 in investments and that the margin call was therefore large, relative to American Fund's value. (Tr. 1218.)

Montanino concedes this margin call was "very alarming" to him. (*Id.*) In fact, Montanino admittedly knew, by March 24, 2010, that Sullivan's trading in the American Fund account was "completely reckless" and would affect the Yoos. (Tr. 1225–26, 1677.) Montanino also admittedly knew by April 13, 2010, when he lost trading authorization, that the American Fund had lost approximately $60,000 and that the Yoos had lost $35,000 to $40,000 of that amount. (Tr. 1226.)

On April 13, 2010 — the same day Sullivan de-authorized Montanino from the American Fund account — Yoo e-mailed Montanino at his American Equity email address, dave@apequity.com. (DE 35.) She asked him: "[H]ow is my portfolio performing? Any way I can get a copy of [a] statement or some kind of proof where the money is?" (DE 35; Tr. 312, 314–15 (Yoo).) In reply, Montanino obfuscated: "The portfolio value is being calculated and it should be available in a week or two." (DE 35.) Echoing Yoo's use of the term "portfolio," meaning multiple investments, Montanino concealed from Yoo that he had invested her money in a single hedge fund — not a separate account with several investments. (Tr. 1248–49 (Montanino) ("Q. …Just so we're clear, you wouldn't use the word portfolio to mean one fund investment, right? A. I wouldn't, no."); Tr. 317 (Yoo).)

Over a week later, on April 22, 2010, Sullivan forwarded Montanino a subscription confirmation, dated March 19, 2010, showing the fund's receipt of the Yoos' $299,000 investment. (DE 37.) Montanino did not forward it to Yoo. (*Id.*) Later that evening, Montanino had a social dinner with the Yoos and their son at a

restaurant. (Tr. 317–18 (Yoo); Tr. 1232 (Montanino).) Montanino did not tell the Yoos that their investment was in a hedge fund, that Montanino no longer had any control over their investment, that their investment had been recklessly traded, or that their investment had lost over $35,000. (Tr. 319–21 (Yoo).)

On May 5, 2010, almost two weeks after the dinner and over two months after the Yoos had made their investment, Montanino forwarded Yoo the subscription confirmation he had received on April 22. (DE 37; Tr. 322–23 (Yoo).) The confirmation provided the date and amount of Yoo's investment but no performance information. (DE 37; Tr. 328–29 (Yoo).) Yoo still had no reason to believe that her investment had lost value or that Montanino no longer managed her investment. (Tr. 330–31 (Yoo).)

The next day, Yoo e-mailed Montanino again:

> Thank you for working hard to set my account up.... I see that there are no numbers or figures available, however, I'm hoping that those will be available soon. Do you have any idea how the money was invested? What funds and what position? I did transfer the funds hoping that you watch the growth bit more closer. Hopefully that's what I'm going to see... You know we know about animals but not much in the area of investment. Thank you and I appreciate your personal attention.

(DE 39 (second ellipsis in original); Tr. 331–32 (Yoo).) When she sent the email, Yoo still did not know how her money had been invested or the value of her account. (Tr. 334–36 (Yoo).) She did not know she had invested in a hedge fund or that she had already lost over $35,000 of her investment. (*Id.*) As her email reflected, she still

expected that Montanino was managing her account. (Tr. 337–38 (Yoo).) Montanino did not e-mail Yoo a response.[11] (Tr. 1243–46 (Montanino).)

F. The American Fund Collapses.

On April 27, 2010, Lime employees internally discussed the American Fund account's unusually frequent margin calls. (DE 164.) On May 7, 2010, Lime decided to liquidate and close the account. (DE 162.) In approximately May 2010 — about three months after it had started trading — the American Fund collapsed. (Tr. 1250–51 (Montanino).)

G. Yoo Receives a Fund Statement and Confronts Montanino.

On or soon after May 19, 2010, Yoo finally received a statement from American Fund's administrator. (DE 43; Tr. 341–42 (Yoo).) The statement showed that Yoo's investment had lost approximately $70,000 as of March 31, 2010. (DE 43; Tr. 346, 348 (Yoo).) Yoo was upset and called Montanino. (Tr. 346, 348–49 (Yoo).) Montanino said he no longer had control of Yoo's money and told her to call Sullivan. (*Id.*) Yoo called Sullivan and set up a meeting. (Tr. 349–50 (Yoo).)

On May 26, 2010, the Yoos arrived at American Equity's offices to meet with Sullivan and Montanino. (Tr. 350 (Yoo); Tr. 1251 (Montanino).) Montanino

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[11] Montanino contends that, at the April 22, 2010 dinner, he told the Yoos that Sullivan had fired him, that Sullivan was managing their account, and that their account had lost roughly $35,000 in value. (Tr. 1232.) Yet Montanino could not explain why Yoo would have asked him how her money had been invested and what its performance was on May 5, 2010, if he had given her that information on April 22, 2010. (Tr. 1245–46 ("It was shocking to me that she would write an e-mail like that… Judge Grimes: Did you send her a responsive email? A: No, I did not.").)

admittedly told the Yoos that day, outside of Sullivan's presence, that they should "[s]hake [Sullivan] really hard" so that Sullivan would give them money from other investors. (Tr. 1502, 1503, 1521, 1651 (Montanino); Tr. 353 (Yoo).) Yoo was alarmed because it sounded like a Ponzi scheme.[12] (Tr. 353–54 (Yoo).)

At the meeting, in Montanino's presence, Sullivan told the Yoos that their funds had been invested in "a big company" based in New York. (Tr. 355–56 (Yoo).) Neither Sullivan nor Montanino told the Yoos their investment was in a hedge fund. (Tr. 356–57 (Yoo).) Sullivan also told them that he thought their investment had lost further value since March, but neither Montanino nor Sullivan provided any details about the extent of the losses. (Tr. 1251–52 (Montanino); Tr. 357–58 (Yoo).)

Yoo asked Sullivan to stop any further investment activity and requested immediate redemption of her remaining funds. (Tr. 357 (Yoo).) Sullivan told her she would have to wait until the second quarter ended on June 30, 2010, to get her money back. (Tr. 359 (Yoo).) Before that, Montanino had never informed Yoo that her investment would be locked up for any period of time. (*Id.*) Yoo was concerned, because she feared her investment might lose further value. (*Id.*)

H. Yoo Finally Learns Her $299,000 Investment Is Gone.

According to Montanino, Sullivan told him on June 30, 2010 that the Yoos' money was gone. (Tr. 1503 (Montanino).) That day, instead of telling Yoo, Montanino

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[12] Montanino contends that he meant that Sullivan could be forced to pay the Yoos "from fund assets" through a lawsuit or lien. (Tr. 1501.) Yet Montanino does not recall whether he told the Yoos to hire a lawyer. (Tr. 1651.)

e-mailed her a one-page American Fund redemption form. (DE 40; Tr. 361–62 (Yoo).) Yoo faxed her signed redemption form to American Equity the same day. (Tr. 368–69 (Yoo).)

The next day, the Yoos left for an overseas trip. (Tr. 364–65 (Yoo).) Before Yoo left, she told Montanino to redeem her investment before she returned. (Tr. 369–70 (Yoo).) Montanino still did not tell Yoo that her money was gone. (Tr. 1252, 1503–04 (Montanino).)

When Yoo returned on approximately July 13, 2010, she called Montanino to ask about the redemption. (Tr. 370 (Yoo).) He told her that there was "nothing left in the account." (Tr. 370, 393 (Yoo).)

Yoo and her husband promptly retained a lawyer. (Tr. 393–94 (Yoo).) On July 21, 2010, their lawyer sent a letter to Sullivan and Montanino demanding all relevant documents and a full accounting. (DE 44; Tr. 394–95 (Yoo).) In response, Sullivan sent Yoo the American Fund Offering Memorandum. (Tr. 396–400 (Yoo); DE 42 at 13; Tr. 301–04 (Yoo) (authenticating DE 42).) Yoo had never seen it before. (Tr. 400–01 (Yoo).) The "Name of Offeree" line on the cover page was blank. (Tr. 403 (Yoo).)

Later that summer, Montanino visited Yoo at her house. (Tr. 430 (Yoo).) Montanino apologized: "I know it is retirement money and I blew it. I'm so sorry, I'll pay you back." (*Id.*) He told Yoo that he and Sullivan were starting a new company

and that Sullivan needed him because Sullivan did not have a securities license. (Tr. 430–31 (Yoo).)

VII. MONTANINO JOINS SULLIVAN'S NEXT VENTURE AND AGAIN DEFRAUDS INVESTORS.

A. Montanino and Sullivan Become Partners in Calibourne And Create a New Hedge Fund.

In May 2010 — two months after learning that Sullivan had been "completely reckless" with the Yoos' investment — Montanino teamed up with Sullivan again to revive the American Equity-Calibourne venture they had abandoned in 2005. (Tr. 1225–26, 1528–31 (Montanino).) On July 22, 2010, less than a month after he learned that Sullivan had lost the Yoos' entire investment, Montanino applied to re-register Calibourne as a California investment adviser. (*Id.*; DE 4.)

Montanino and American Equity each owned 50% of Calibourne, and Sullivan and Montanino were partners in Calibourne. (Tr. 1524 (Montanino); R5; Tr. 1007, 1018–20, 1029 (Lindsey); DE 154A at 26.) Calibourne did not pay its own bills; instead, American Equity apparently paid Calibourne's vendors directly. (Tr. 1259, 1682–83 (Montanino).) Sullivan determined how much of Calibourne's bills American Equity would pay. (*Id.*) Neither American Equity nor Calibourne ever accounted for any such payments. (Tr. 1681–83 (Montanino).)

Montanino and Sullivan simultaneously created a new hedge fund, American Private Fund II ("American Fund II"). (Tr. 1523–24, 1658–60 (Montanino).) Montanino — whose sole hedge fund experience was his twenty-five-day tenure at

American Fund — was American Fund II's portfolio manager. (Tr. 1524, 1556, 1659–60, 1662 (Montanino)); *see supra* pps. 18, 24.

Sullivan was responsible for hiring investment advisers to work at Calibourne. (Tr. 1545, 1656–58, 1677–80 (Montanino).) Montanino admittedly understood that any investment advisers Calibourne hired would have a fiduciary duty to their clients. (Tr. 1658.) Yet Montanino and Sullivan planned to have Calibourne's investment advisers sell investments in American Fund II to Calibourne's clients. (Tr. 1658–60 (Montanino).) Calibourne would offer to pay its advisers generously, because Calibourne and American Equity planned to make money from the management fees American Fund II would charge its investors. (*Id.*; Tr. 1552–54 (Montanino).) Montanino claims he expected American Fund II to obtain investors even after he disclosed to potential investors that Sullivan had made "completely reckless" margin trades in the predecessor American Fund and that American Fund had collapsed in about four months. (Tr. 1662–63.)

By at least September 2010, Montanino knew of Sullivan's [redacted] problems and "started to lose confidence" in Sullivan. (Tr. 1668–69 (Montanino).) By December 2010, Montanino admittedly knew that Calibourne had significant financial issues and was desperate for investments. (Tr. 1258–60, 1608.) By then, Calibourne could not pay its printer $10,000 for marketing materials unless American Equity brought in new investors. (*Id.*; Tr. 1004, 1015–16, 1038–41 (Lindsey); DE 55 at 3.)

B. Montanino Drafts a Misleading Investor Presentation.

Montanino worked for American Equity. (DE 154A (from "dave@apequity.com").) As he admits, he drafted marketing materials for American Equity and Calibourne, including the approximately 40-page-long American Equity investor presentation (the "American Equity Presentation"). (Tr. 1531–32, 1622–23; DE 56.) He wrote all the content, worked with a graphic designer and editor to give the materials a professional look, and knew that Sullivan used these documents to market American Equity to potential investors. (Tr. 1258, 1531–32, 1581 (Montanino); Tr. 1020–22 (Lindsey).)

The American Equity Presentation projected quick, enormous profits for American Equity investors based on the Calibourne strategy — despite Montanino's knowledge of Sullivan's disastrous track record and substance abuse, Montanino's own lack of experience, and Calibourne's financial difficulties. The American Equity Presentation represented: "Company Management believes that American Private Equity, LLC will become profitable very quickly and may only be in a cash flow negative position for 12 months or less." (DE 56 at 36.) It similarly projected that, if American Equity raised $5 million from investors, it would use the money to purchase "between $300–400 Million in financial assets within the first year" and then be able to sell Calibourne for $35 million to $70 million — a seven- to fourteen-fold increase. (DE 56 at 37–39.)

Montanino also misrepresented his experience in the American Equity Presentation. He falsely claimed that Fidelity had "recruited" him to help open its Santa Monica investor center and that he had been "tasked with developing financial planning strategies, and providing investment management services for a client base with over $1 Billion in assets under management." (DE 56 at 40); *see supra* pps. 10–13.

On December 9, 2010, Sullivan e-mailed the American Equity Presentation to Pankey, who later invested $100,000 in American Equity. (DE 56; DE 181B.) On January 5, 2011, Sullivan e-mailed the same presentation to Jeffrey Tilem ("Tilem"), who later invested $50,000 in American Equity. (DE 182; DE 181B at 1; Tr. 1304 (Tilem).) In deciding whether to invest, both Pankey and Tilem placed weight on at least Montanino's biography in the American Equity Presentation. (Tr. 826–28, 874–76 (Pankey); DE 56 at 40; Tr. 1320–21 (Tilem); DE 182 at 38.)

C. Montanino Misleads Pankey and Misappropriates $11,000.

In late 2009 or early 2010, Pankey invested $100,000 in American Equity after speaking with Sullivan. (Tr. 723–24, 728 (Pankey).) In June 2010, Pankey made a second investment of $500,000 in American Equity. (Tr. 729 (Pankey); DE 181B at 1; Tr. 979, 981–82 (Sacco).) He understood he was investing in American Equity as "a vehicle for investing in Calibourne." (Tr. 856 (Pankey).)

Before Pankey made his second investment of $500,000, he spoke with Montanino and Sullivan together approximately three times by phone. (Tr. 731–32, 733–37, 879–80 (Pankey).) Montanino was an "active participant" in soliciting Pankey.

(Tr. 879–80 (Pankey).) Montanino and Sullivan assured Pankey that his second investment in American Equity would be used for Calibourne's formation expenses, including recruiting investment advisers to Calibourne. (*Id.*; DE 138 ¶ 35; Tr. 1276–78 (Montanino).)

Montanino never told Pankey that American Equity and Calibourne had tried and failed at a similar venture in 2005, which would have raised questions about the investment in Pankey's mind. (Tr. 882–85 (Pankey).) He never told Pankey that he had worked for American Fund for less than a month before Sullivan had de-authorized him from its account. (Tr. 1283 (Montanino).) He also never told Pankey that Sullivan had engaged in "completely reckless" trading in the American Fund. (*Id.*) In the month after Pankey made his $500,000 investment, Sullivan misappropriated $343,000 of it. (DE 181B at 2.)

In March 2011, after Pankey had received the American Equity Presentation, Montanino and Sullivan jointly solicited a third investment from Pankey. (DE 56; Tr. 791–94, 880 (Pankey).) American Equity had received its last investment of $50,000 almost two months earlier, on January 27, 2011. (DE 181B at 1.) As Montanino knew by at least mid-March, that money had already been spent. (Tr. 1046–47 (Lindsey); DE 70 at 1.)

Montanino and Sullivan told Pankey that, in order to recruit investment advisers, American Equity and Calibourne needed to give them signing bonuses. (Tr. 791–94, 880 (Pankey).) To do so, they said American Equity needed more capital.

(*Id.*) They asked Pankey to make a third investment to provide capital to pay the signing bonuses. (*Id.*)

Pankey made clear to both Montanino and Sullivan that he would only make a third investment if it was used solely to pay signing bonuses to Calibourne recruits. (Tr. 794–96, 797–99, 800–03 (Pankey).) Montanino and Sullivan agreed.[13] (*Id.*) By then, Pankey already had "a sunk cost...of $600,000" and believed that, if he did not contribute capital for the signing bonuses, he would lose his entire investment because Calibourne would be unable to recruit advisers. (Tr. 866–67 (Pankey).) A few days later, on March 24, 2011, Pankey invested another $100,000 in American Equity. (Tr. 796, 803 (Pankey); DE 181B.) He would not have done so without Montanino's and Sullivan's assurance as to its use. (Tr. 797–98, 800–01 (Pankey).)

Twelve days later, on April 6, 2011, Montanino personally received a check for $11,000 from Pankey's final investment. (Tr. 1280–81 (Montanino); DE 17C-4 at 8.)

On approximately April 17, 2011, Sullivan died [redacted] (Tr. 1286 (Montanino); Tr. 1048–49 (Lindsey); DE 85.) At the time, Montanino admittedly knew that Calibourne had not hired any investment advisers and had no clients, assets under management, or revenue. (Tr. 1287.) Nor had American Fund II ever operated. (Tr. 1667 (Montanino).)

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[13] Montanino disputes this conversation but admits he did not tell Pankey that he would personally take some of Pankey's investment. (Tr. 1280–81, 1570–71.)

Over a month later, Montanino called Pankey to tell him of Sullivan's death. (Tr. 806 (Pankey).) Pankey asked him whether Calibourne had recruited any advisers and paid them signing bonuses, and Montanino said no. (Tr. 806–07 (Pankey).) Pankey asked Montanino where his $100,000 investment was since it had not been spent to recruit advisers. (*Id.*) Montanino claimed to have no knowledge of American Equity's finances. (*Id.*)

On June 20, 2011, Pankey emailed Montanino to ask about his investment again: "[T]he investment of $100k March 24 investment was not spent as specified at the time of investment (ie, for acquisition of investment advisers for Calibourne). Where are those funds? How were those funds spent?" (DE 111; Tr. 817–20 (Pankey).) Montanino did not tell Pankey that he had taken $11,000 of Pankey's investment. (Tr. 823 (Pankey).) Pankey eventually lost his entire $700,000 investment in American Equity.[14] (Tr. 823–24 (Pankey).)

VIII. MONTANINO RECEIVES AT LEAST $89,340 FROM AMERICAN EQUITY.

From December 2009 through April 7, 2011, Montanino received at least $67,500 directly from American Equity as compensation, including $11,000 of Pankey's final investment. (Tr. 1280–82 (Montanino); DE 181C at 1 (amounts directly paid to Montanino); Tr. 986 (Sacco).) In addition, Calibourne received just $22,515

[14] He later received just $30,000 back through a separate regulatory action not involving Montanino. (Tr. 824 (Pankey).)

from American Equity, not including $11,500 that Montanino transferred back to American Equity. (Tr. 1562–63 (Montanino); DE 18A at 1.) Of this $22,515, Montanino took $21,840 for himself. (DE 18A (transfers from Calibourne to Montanino's account no. 1985); 17B-3 at 3, 55, 65 (examples of American Equity checks deposited into account no. 1985); Tr. 986 (Sacco).)

IX. MONTANINO PARTIALLY CONFESSES TO TILEM BUT SECRETLY PAWNS SULLIVAN'S COMPUTER.

By at least May 4, 2011, Montanino had obtained Sullivan's office computer. (Tr. 1296–98 (Montanino) (held computer for at least three weeks); DE 95; DE 96 at 5 (pawn date of May 25, 2011); DE 97.) On May 4, 2011, Montanino told Lindsey that he would be meeting with Sullivan's lawyer the following week. (Tr. 1298–99 (Montanino); DE 83 at 3.) But Montanino did not give Sullivan's computer to Sullivan's lawyer. (Tr. 1298 (Montanino).) Instead, he pawned the computer on May 25, 2011. (Tr. 1298–99 (Montanino); DE 95; DE 96 at 5.)

Around that time, Tilem contacted Montanino. (Tr. 1335, 1337–38 (Tilem); DE 85 at 5.) After initially obfuscating, Montanino later admitted that Calibourne had "no office, no revenue, no advisors working for [him], and no capital to run operations." (Tr. 1338, 1340 (Tilem); DE 85 at 4; DE 143 at 1.) Tilem was alarmed. (Tr. 1341–42 (Tilem).)

On June 8, 2011, Tilem and his father, a lawyer, met with Montanino in person. (Tr. 1343 (Tilem).) Montanino told Tilem about his long relationship with Sullivan,

including that Sullivan "had had his Series 7 NASD license forfeited." (DE 90 at 1; Tr. 1343, 1346–52 (Tilem) (in part authenticating DE 90).) Montanino admitted that he and Sullivan "were going to set up 3 hedge funds, none of which succeeded." (DE 90 at 1.) Montanino revealed that, by December 2010, Sullivan had become hostile towards Montanino and had had [redacted] problems. (*Id.* at 2, 3.) Montanino even admitted that he had been present when Sullivan had made false statements to potential American Equity investors:

> There were several times David [Montanino] had to contradict Tim [Sullivan] when Tim would make outlandish statements [bold lies!] in talking to potential investors while David was present, like assuring investors there was no chance they could lose in this new venture.

(*Id.* at 2 (third brackets in original); Tr. 1362–63 (Tilem).)

Despite his track record, Montanino told Tilem that he was trying to start another firm and had talked to another investor "who might put up $800,000." (DE 90 at 2–3.) Montanino said he would "use the legal documents already drafted" for American Equity "and only change the names to the new company." (*Id.*; Tr. 1369 (Tilem).)

Finally, Montanino told Tilem that he had taken Sullivan's computer from American Equity's offices after Sullivan's death. (Tr. 1363–65 (Tilem); DE 90 at 2.) To trace his investment, Tilem asked to see the hard drive. (Tr. 1364 (Tilem); DE 90 at 2.) Montanino refused and told Tilem he would give it to law enforcement

authorities if asked. (Tr. 1363–65 (Tilem); DE 90 at 2.) Montanino did not tell Tilem that he had pawned the computer two weeks before. (Tr. 1365 (Tilem).)

ARGUMENT

I. MONTANINO WILLFULLY VIOLATED THE ANTIFRAUD PROVISIONS OF THE ADVISERS ACT.

A. Montanino Willfully Violated Sections 206(1) and 206(2).[15]

Sections 206(1) and (2) of the Investment Advisers Act of 1940 ("Advisers Act") prohibit an investment adviser from defrauding his clients. 15 U.S.C. § 80b-6(1) & (2). These provisions impose a statutory fiduciary duty on investment advisers "to exercise the utmost good faith in dealing with clients, to disclose all material facts, and to employ reasonable care to avoid misleading clients" before and after clients invest money with their advisers. *SEC v. Moran*, 922 F. Supp. 867, 895–96 (S.D.N.Y. 1996) (citing, *inter alia*, *SEC v. Capital Gains Research*, 375 U.S. 180, 191–92 (1963)); *SEC v. Washington Inv. Network*, 475 F.3d 392, 404 (D.C. Cir. 2007) ("Section 206 prohibits failures to disclose material information, not just affirmative frauds."); *David Henry Disraeli*, 2007 WL 4481515, at *8 (Dec. 21, 2007) (Commission opinion).

15 "Willfully" means that the respondent voluntarily committed the act that constitutes the violation — not that he knew he was violating the law. *John P. Flannery*, 2014 WL 7145625, at *37 (Dec. 15, 2014) (Commission opinion).

1. *Montanino Willfully Violated Sections 206(1) and (2) By Defrauding Yoo.*

a. Montanino Was Yoo's Investment Adviser.

Advisers Act Section 202(a)(11) defines an "investment adviser" to include any person "who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities." 15 U.S.C. § 80b-2(11); *see also Abrahamson v. Fleschner,* 568 F.2d 862, 870 (2d Cir. 1977) (defining "investment adviser" to include anyone who manages "the funds of others for compensation").

First, "compensation" is any economic benefit or expectation of an economic benefit and may include misappropriation. *See, e.g., Alexander V. Stein,* 1995 WL 358127, at *2 (June 8, 1995) (Commission opinion) (misappropriation); *SEC v. Fife,* 311 F.3d 1, 11 (1st Cir. 2002) (expectation of compensation). Montanino met this requirement because Sullivan had promised to compensate him for managing American Fund if it did well and Montanino had told Yoo he would charge her 10% of her investment's profits.[16]

Second, Yoo was Montanino's client because he advised her personally on securities investments. For fraud on an advisory client under Sections 206(1) and (2), an adviser to an investment fund generally has only one client, the fund itself. *See Goldstein v. SEC,* 451 F.3d 873, 881–83 (D.C. Cir. 2006). Yet "certain characteristics present in some [fund] investor-adviser relationships [may] mark a 'client'

[16] All record citations are provided above in the Statement of Facts.

relationship." *Id.* at 883. Recognizing this exception, several federal courts have held that a fund adviser may be an adviser to the fund's individual investor when the adviser provides personalized advice to the investor. *See United States v. Lay*, 612 F.3d 440, 446–47 (6th Cir. 2010); *SEC v. Lauer*, 478 Fed. Appx. 550, 556–57 (11th Cir. 2012); *SEC v. ICP Asset Management, LLC*, 2012 WL 2359830, at *3 (S.D.N.Y. June 21, 2012); *Goldenson v. Steffens,* 802 F. Supp. 2d 240, 268 (D. Me. 2011).

In *Lay*, the Sixth Circuit denied defendant's motion for an acquittal or new trial following an Advisers Act criminal conviction and held that the jury was properly instructed that the defendant, a hedge fund adviser, could have a fiduciary duty to a fund investor. 612 F.3d at 445–46. The court found that certain factors — including that the investor was the fund's only investor at the relevant time and that the investor played an active role in the fund through meetings with the fund's adviser — supported the jury's conclusion that such a fiduciary duty existed. *Id.*

Similarly, in *Lauer*, the Eleventh Circuit held that "a client-adviser fiduciary relationship can arise when a hedge fund investor receives direct investment advice from a hedge fund adviser." 478 Fed. Appx. at 557. In *Goldenson,* the district court likewise declined to dismiss claims pleading an investment adviser relationship between a fund adviser and individual fund investors. 802 F. Supp. 2d at 267. The court pointed to several factors alleging such a relationship:

> a long course of dealing between the [investors] and [the adviser], a personal friendship, a switch whereby they followed him when he changed investment firms, a request for investment advice, a

> recommendation to invest in a relatively esoteric form of investment concerning which he professed specialized knowledge, and repeated assurances of his personal involvement with and monitoring of the investments.

Id.

Montanino's personal relationship with Yoo falls squarely within this exception. First, Montanino and Yoo had a prior professional and personal friendship, when Montanino helped her with her Fidelity investments, took his dogs to her husband's veterinary practice, and socialized with her. Second, Montanino orally assured Yoo that he would personally manage her investment. Third, Montanino misled Yoo into believing that her investment would be in a separate account — not a hedge fund. Fourth, for the first fifteen days after she made her investment, Yoo was the only investor in American Fund. Finally, after investing, Yoo continued to direct virtually all of her questions about her investment to Montanino.[17]

b. Montanino Materially Deceived Yoo With Scienter.

Sections 206(1) and (2) require an adviser to disclose only material facts. *Washington Inv. Network*, 475 F.3d at 404. Misstatements or omissions are material if a reasonable investor would have considered the information important in deciding whether to invest. *ZPR Investment Mgmt.*, 2014 WL 2191006, at *50 (May 27, 2014) (initial decision) (citing cases). Materiality does not require proof that an accurate

[17] If the Court nevertheless finds Montanino was not Yoo's adviser, then Montanino would be liable for his fraud on Yoo under Section 206(4) and Rule 206(4)-8 instead, because she was an investor in American Fund, a pooled investment vehicle for which Montanino served as an investment adviser. *See infra* p. 46.

disclosure would have caused a reasonable investor to change her decision, but only that an omitted fact would have been significant in the investor's deliberations. *Id.*

Section 206(1) violations also require a finding of scienter.[18] *See, e.g., SEC v. Steadman*, 967 F.2d 636, 641 n.3 (D.C. Cir. 1992); *Steadman v. SEC*, 603 F.2d 1126, 1134 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981). The scienter requirement is satisfied by "extreme recklessness," an "extreme departure from the standards of ordinary care, ...which presents a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the actor must have been aware of it." *SEC v. Steadman*, 967 F.2d at 641.

Montanino materially defrauded Yoo, both before and after she invested, with scienter. Before Yoo invested, Montanino told her he would personally manage her account and would invest her funds in assets with moderate to low risk. He also led her to believe she would have an individual account rather than a hedge fund investment. Yet as Montanino then knew from his review of the Offering Memorandum, her investment would be in a hedge fund, Sullivan controlled the hedge fund, and Sullivan could trade on margin in the fund if he wanted. Indeed, Montanino never gave Yoo the Offering Memorandum, because he knew that she would never invest if she knew the truth, like any similar reasonable investor. *See SEC v. Sentinel Mgmt. Group, Inc.*, 2012 WL 1079961, at *3 (N.D. Ill. Mar. 30, 2012)

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[18] Violations of Section 206(2) require a finding of only negligence, not scienter. *See, e.g., Washington Inv. Network*, 475 F.3d at 396.

(adviser's failure to disclose fund's excessive use of leverage and associated risks to clients was material as a matter of law); *Gualario & Co, LLC*, 2012 WL 627198, at *13 (Feb. 14, 2012) (initial decision) (failure to disclose risky investment strategy, including borrowing heavily on margin, was a material omission); *Goldenson*, 802 F. Supp. 2d at 263 (adviser's assurances that he would personally manage investors' account were material).

After she invested, Montanino continued to knowingly conceal material facts from Yoo, including her investment in a hedge fund. By March 24, 2010, Montanino learned that Sullivan had engaged in "completely reckless" margin trading that would result in losses to the Yoos. By April 13, 2010, Montanino knew that the Yoos had lost over $35,000 of their $299,000 investment. Yet Montanino failed to tell Yoo these facts or even give her basic account information until it was too late. Had Montanino exercised his fiduciary duty and told Yoo the truth even in late March or early April 2010, Yoo could have hired a lawyer and forced Sullivan to return her funds before he dissipated her entire investment. *See, e.g., Hennessee Group LLC*, 2009 WL 1077451, at *9 (Apr. 22, 2009) (settled Commission order) (advisers breached their fiduciary duties "to not misrepresent the services that they were providing and to disclose all material departures from the representations that they made to their clients").

2. *Montanino Willfully Violated Sections 206(1) and 206(2) By Misappropriating Funds from American Equity, His Client.*

Montanino was an investment adviser to American Equity, a private equity fund, because he managed "the funds of others for compensation." *Abrahamson,* 568 F.2d at 870. First, Montanino worked for American Equity, as his business card and business email address reflected. Second, he and Sullivan jointly created American Equity's strategy of investing in Calibourne. Third, Montanino prepared investment reports for American Equity about securities market trends and marketing documents describing its Calibourne investment strategy, which he knew would be distributed to American Equity investors. Finally, Montanino obtained in return at least $67,500 in compensation directly from American Equity.

Montanino defrauded American Equity by misappropriating its funds for his own use. *See Brendan E. Murray*, 2008 WL 4964110, at *5 (Nov. 21, 2008) (Commission opinion) ("Misappropriation of client funds by an investment adviser violates Sections 206(1) and 206(2)."). On March 24, 2011, Pankey made a final American Equity investment of $100,000 only because Montanino and Sullivan had represented that it would be used solely to pay signing bonuses to new Calibourne advisers. Yet on April 7, 2011, Montanino personally received $11,000 from American Equity. Montanino knew or recklessly disregarded that it came from Pankey's American Equity investment, because he knew, just before Pankey invested, that American Equity had already depleted its existing capital.

B. Montanino Willfully Violated Section 206(4) and Rule 206(4)-8.

Advisers Act Section 206(4) and Rule 206(4)-8 thereunder prohibit an adviser from making material misrepresentations or omissions to, or otherwise defrauding, existing or prospective investors in a pooled investment vehicle, such as a hedge fund or a private equity fund. 15 U.S.C. § 80b-6(4); 17 C.F.R. § 275.206(4)-8. These provisions, like Section 206(2), require a finding of only negligence, not scienter. *See SEC v. Steadman*, 967 F.2d at 647; *In re Reserve Fund Sec. & Deriv. Litig.*, 2013 WL 5432334, at *12 (S.D.N.Y. Sept. 30, 2013). Montanino defrauded prospective investors in American Equity through written, material misrepresentations in the American Equity Presentation and oral, material misrepresentations to Pankey.

First, in the American Equity Presentation, Montanino projected a seven- to fourteen-fold return on investment without any basis. *See, e.g., Lapin v. Goldman Sachs Group, Inc.,* 506 F. Supp. 2d 221, 239 (S.D.N.Y. 2006) ("[O]ptimistic statements may be actionable upon a showing that the defendants did not genuinely or reasonably believe the positive opinions they touted (i.e., the opinion was without a basis in fact or the speakers were aware of facts undermining the positive statements)."). Montanino had no basis for this projection because he knew that: (1) Sullivan had made "completely reckless" trades in the American Fund earlier that year, causing the American Fund to collapse in about four months; (2) Sullivan had substance abuse problems; (3) American Equity's and Calibourne's finances were precarious; (4) American Equity's plan to make money through Calibourne depended on

Calibourne's ability to sell investments in American Fund II to Calibourne's own advisory clients; and (5) to do so, Montanino and Sullivan would have to conceal American Fund's quick collapse and Sullivan's reckless trading from potential investors. The projections were therefore misleading, which Montanino at least negligently disregarded.

A reasonable investor would have found these baseless, misleading profit projections material in deciding whether to invest in American Equity, because an investment's future profits are of utmost importance in deciding whether to invest. *See, e.g., SEC v. Tecumseh Holdings Corp.*, 765 F. Supp. 2d 340, 350–55 (S.D.N.Y. 2011).

Second, Montanino falsely represented in the American Equity Presentation that Fidelity had "recruited" him and that he had managed over $1 billion of Fidelity clients assets. In reality, he had submitted a signed, certified application to Fidelity replete with lies, because he knew Fidelity would not have hired him with knowledge of his employment history. Also, Montanino had never managed any customer assets at Fidelity. To the extent that he assisted Fidelity customers with products and services, his customers' investments at Fidelity totaled $400 to $500 million, not $1 billion. These misstatements were important to both Pankey and Tilem in deciding whether to invest in American Equity. *See, e.g., Marbury Mgmt., Inc. v. Kohn,* 470 F. Supp. 509, 513 (S.D.N.Y. 1979) (false statements concerning professional expertise in the securities field qualified as securities fraud), *rev'd in part on other grounds,* 629 F.2d 705 (2d Cir. 1980).

Third, as described above, Montanino and Sullivan misrepresented to Pankey that his final $100,000 American Equity investment would be used only to pay signing bonuses to new Calibourne recruits and therefore defrauded him. *See supra* p. 45.

II. MONTANINO WILLFULLY VIOLATED ANTI-FRAUD PROVISIONS OF THE SECURITIES ACT AND EXCHANGE ACT.

To establish Montanino's liability for a primary violation of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5, the Division must show that Montanino "engaged in fraudulent conduct, that such conduct was in connection with the offer, sale, or purchase of securities, and that he acted with scienter, or in the case of Section [17(a)(2) or] 17(a)(3), with negligence." *Thomas C. Gonnella*, 2014 WL 5866859, at *12 (Nov. 13, 2014) (initial decision) (internal quotation marks and citations omitted); *Aaron v. SEC*, 446 U.S. 680, 685, 696 (1980).[19]

A. Montanino Engaged in Fraudulent Conduct.

Montanino violated Section 17(a), Section 10(b), and Rule 10b-5(b) by making materially false statements and omissions to induce investors to invest and engaging in fraudulent schemes. As described above, Montanino made material misrepresentations and omissions to Yoo before she invested, misrepresented to

[19] Montanino's use of phone and email to defraud Yoo and Pankey also satisfies the interstate commerce requirement. *See* 15 U.S.C. §§ 77q & 78j(b); 17 C.F.R. § 240.10b-5; *SEC v. Stanard*, 2009 WL 196023, at *25 (S.D.N.Y. Jan. 27, 2009) (phone calls sufficient); *SEC v. Ramoil Mgmt., Ltd.*, 2007 WL 3146943, at *8 (S.D.N.Y. Oct. 25, 2007) (emails sufficient).

Pankey the use of his final $100,000 investment, and made material misrepresentations and omissions in the American Equity Presentation, which mattered to Pankey and Tilem in their investment decision. *See supra* pps. 42–48.

B. Montanino Had the Requisite Scienter.

Montanino acted with scienter. For the reasons described above, Montanino knew (or at least recklessly disregarded) the falsity of his misrepresentations and omissions and knew (or recklessly disregarded) that his schemes were deceptive. *See supra* pps. 42–48. In addition, Montanino's lies and omissions to investors after they had invested — including his continued failure to tell Yoo that her investment was in a hedge fund and had been traded recklessly on margin, his concealment from Yoo of the true extent of her losses, and his representation to Tilem that he had Sullivan's computer, when in fact Montanino had already pawned it — further demonstrate Montanino's scienter. *See, e.g., United States v. Kelley*, 551 F.3d 171, 176 (2d Cir. 2009) (broker's concealment of his fraud through further misrepresentations was admissible to show his intent).

C. Montanino Acted In Connection With the Sale of Securities.

The "in connection with" requirement should be construed broadly "to encompass the entire selling process." *United States v. Naftalin*, 441 U.S. 768, 773 (1979). Montanino's misrepresentations, omissions, and deceptive schemes occurred "in connection with" his sale of securities — investments in American Equity, a private equity fund, and American Fund, a hedge fund — to investors.

III. MONTANINO AIDED AND ABETTED AND CAUSED AMERICAN EQUITY'S FRAUD.

Montanino willfully aided and abetted and caused American Equity's violations of Securities Act Section 17(a)(2), Exchange Act Section 10(b), Rule 10b-5(b), and Advisers Act Sections 206(1) and (2) by incorporating materially false or misleading statements and omissions into the American Equity investor presentation he prepared. To prove that Montanino aided and abetted a fraud, the Division must show: (1) the existence of a fraud; (2) Montanino's general awareness or knowledge that his role was part of an overall activity that was improper; and (3) Montanino's knowing, substantial assistance in the violative conduct. *See Daniel Bogar*, 2013 WL 3963608, at *20 (Aug. 2, 2013) (initial decision). Recklessness satisfies the awareness requirement if sufficient red flags or suspicious events created reason to doubt the propriety of the conduct. *Id.* Substantial assistance "can be established by showing that the [respondent] joined the specific venture and shared in it, and that his efforts contributed to its success, or, in other words, by showing that [he] consciously assisted the commission of the specific [violation] in some active way." *SEC v. DiBella*, 587 F.3d 553, 566 (2d Cir. 2009) (citation omitted).[20]

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[20] A respondent "causes" a violation if: (1) a primary violation occurred; (2) an act or omission by the respondent served as a cause of the violation; and (3) the respondent knew or should have known that his conduct would contribute to the violation. *See Robert M. Fuller*, 2003 WL 22016309, at *4 (Aug. 25, 2003) (initial decision). Negligence suffices where the primary violation requires no scienter. *See KPMG, LLP v. SEC*, 289 F.3d 109, 120 (D.C. Cir. 2002).

Montanino aided and abetted the anti-fraud provisions by including baseless projections about American Equity's returns and misrepresentations about his investment management experience in the American Equity Presentation. First, for the reasons described above, these statements were fraudulent and Montanino knew or recklessly disregarded that they were false or misleading. *See supra* pps. 42–48. Second, Montanino substantially participated in the fraud because he prepared the presentation himself.

IV. THE COURT SHOULD IMPOSE MEANINGFUL REMEDIES.

A. The Court Should Order Montanino to Cease and Desist.

Securities Act Section 8A, Exchange Act Section 21C, and Advisers Act Section 203(k) authorize the imposition of a cease-and-desist order on any person who has violated any provision of the Securities Act, Exchange Act, Advisers Act or the rules and regulations thereunder. 15 U.S.C. §§ 77h-1, 78u-3 & 80b-3(k). In determining whether a cease-and-desist order is appropriate, the Commission considers: (1) the egregiousness of the violator's actions, (2) the isolated or recurrent nature of the violations, (3) the degree of scienter, (4) the sincerity of the violator's assurances against future conduct, (5) the violator's recognition of his wrongful conduct, and (6) the likelihood that the violator's occupation will present opportunities to commit future violations. *Steadman v. SEC*, 603 F.2d at 1140; *Gonnella*, 2014 WL 5866859, at *29 (citing cases). The Commission also considers "the recency

of the violation, the resulting harm to investors, and the effect of other sanctions." *Gonnella*, 2014 WL 5866859, at *30.

These factors warrant a cease-and-desist order against Montanino. First, Montanino's actions were egregious, recurrent, and committed with a high degree of scienter. He flagrantly disregarded his fiduciary duties to his clients by materially misleading them before and after they invested and engaged in a six-year pattern of deception, ending in 2011 only with Sullivan's death. Second, Montanino has failed to recognize his unlawful conduct and contradicted his own prior sworn statements in regulatory filings while testifying under oath. Third, the harm to investors — who collectively lost at least $474,000 from Montanino's fraud — was significant. The public interest therefore requires a cease-and-desist order to prevent Montanino from future securities law violations.

B. The Court Should Issue Permanent Collateral and Investment Company Bars Against Montanino.

Advisers Act Section 203(f) authorizes the Commission to bar from the securities industry a willful violator (or willful aider and abetter of violations) of the federal securities laws who was associated with an investment adviser during his misconduct. A collateral bar prohibits such an individual "from being associated with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization." 15 U.S.C. § 80b-3(f). Section 9(b) of the Investment Company Act of 1940 further authorizes

the Commission to bar any willful violator of the Securities or Exchange Acts from "serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter." 15 U.S.C. § 80a-9(b). The *Steadman* factors should be applied to determine an industry bar's scope and duration. *See Alfred Clay Ludlum, III*, 2013 WL 3479060, at *4–7 (July 11, 2013) (Commission opinion); *John W. Lawton*, 2012 WL 6208750, at *10–1203)3 (Dec. 13, 2012) (Commission opinion).

First, for the reasons described above, Montanino was an investment adviser to at least Yoo and American Equity. *See supra* at 40–42, 45; *Stein*, 1995 WL 358127, at *2 (unregistered advisers subject to administrative bars).

Next, Montanino poses a serious risk to the investing public. He defrauded at least four investors in three different fraudulent schemes over the course of six years. His fraud caused Jones, Yoo, Pankey, and Tilem to lose at least $474,000, including substantial portions of Jones' and Yoo's retirement savings. As he admits, he lied to get a job at Fidelity, and his hearing testimony failed to accept responsibility and defied credibility. Even after Sullivan's death, he told Tilem he was soliciting investments for a new venture and would simply replace American Equity's name on investor disclosures with the new venture's name. The public interest warrants nothing short of permanent collateral and investment company bars to keep Montanino from swindling investors. "[F]idelity to the public interest requires a severe

sanction when a respondent's misconduct involves fraud because the securities business is one in which opportunities for dishonesty recur constantly." *Phillip J. Milligan*, 2010 WL 1143088, at *4 (Mar. 26, 2010) (Commission opinion) (internal quotation marks and citation omitted).[21]

C. The Court Should Order Montanino To Disgorge $105,295.73 In Ill-Gotten Gains, Including Prejudgment Interest.

Securities Act Section 8A(e) , Exchange Act Section 21C(e) , and Advisers Act Section 203(j) authorize the Commission to order disgorgement of ill-gotten gains, including prejudgment interest, based on willful violations of any of those statutory acts or rules or regulations thereunder. 15 U.S.C. §§ 77h-1(e), 78u-3(e) & 80b-3(j). Montanino obtained at least $89,340 from American Equity in return for his role in the fraud, including his misappropriation of $11,000. Based on the Internal Revenue Service tax underpayment rates, pre-judgment interest totals $15,955.73, from January 1, 2010, the month Montanino first received payment from American Equity, through December 31, 2014. *See SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1476 (2d Cir. 1996) ("That rate reflects what it would have cost to borrow the money from the government and therefore reasonably approximates one of the benefits the defendant derived from its fraud.").

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[21] A collateral bar under the Dodd-Frank Wall Street Reform and Consumer Protection Act would not be retroactive. *See* 15 U.S.C. § 78o(b)(6)(A); Pub. L. No. 111-203, 124 Stat. 1376 (2010). Montanino's fraud continued into 2011, well after the effective date of the relevant provisions.

D. The Court Should Order Montanino To Pay the Maximum Third-Tier Civil Penalty.

Securities Act Section 8A, Exchange Act Section 21B, and Advisers Act Section 203(i) authorize the Commission to order civil monetary penalties based on willful violations of those acts or rules or regulations thereunder. 15 U.S.C. §§ 77h-1, 78u-2 & 80b-3(i). To order payment of monetary penalties, the Commission must find that such penalties are in the public interest, based on the following relevant factors: (1) deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require. 15 U.S.C. §§ 77h-1(g), 78u-2(c) & 80b-3(i)(3).

A three-tier system identifies the maximum amount of civil penalties, depending on the severity of the respondent's conduct. 15 U.S.C. §§ 77h-1(g), 78u-2(b) & 80b-3(i)(2). Third-tier penalties are imposed where a respondent commits fraud *and* where the conduct directly or indirectly (i) resulted in substantial losses, (ii) created a significant risk of substantial losses to other persons, or (iii) resulted in substantial pecuniary gain to the person who committed the act. *Id.*

These factors together weigh in favor of the maximum third-tier penalty. Montanino knowingly deceived at least four investors in three different schemes over six years, often in violation of his fiduciary duty. He caused investors to lose over $474,000, including a significant portion of Jones' and Yoo's retirement savings. He

personally profited by over $89,000 from his fraud, including at least $11,000 he misappropriated, and would have profited more if Sullivan had not died unexpectedly.

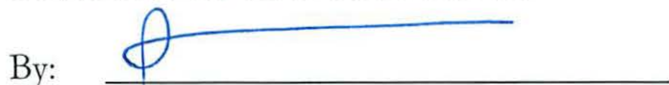
The maximum third-tier penalty for *each violation* by Montanino during the relevant period is $150,000. 15 U.S.C. §§ 77h-1(g), 78u-2(b), 80a-9(d), 80b-3(i); 17 C.F.R. § 201.1004. To calculate the number of violations, courts have used various methods. *See, e.g., SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 288 n.7 (2d Cir. 2013) ("[W]e find no error in the district court's methodology for calculating the maximum penalty by counting each late trade as a separate violation."); *SEC v. Pattison*, 2011 WL 723600, at *5 (N.D. Cal. Feb. 23, 2011) ("The Court may assess a penalty for each distinct violation."); *SEC v. Coates*, 137 F. Supp. 2d 413, 428, 430 (S.D.N.Y. 2001) (counting each category of misrepresentations as a violation); *SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 17 n.15 (D.D.C. 1998) ("multiplying the maximum third tier penalty for natural persons...by the number of investors who actually sent money to [defendant]"). To deter would-be fraudsters, the Court should calculate Montanino's violations to impose the maximum third-tier penalty.

CONCLUSION

For the foregoing reasons, the Division has proven by more than a preponderance of the evidence that Montanino violated the anti-fraud provisions as alleged. The Court should impose the maximum relief against Montanino.

Dated: New York, New York
December 19, 2014

DIVISION OF ENFORCEMENT



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