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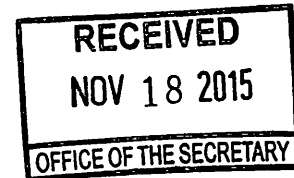
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15967

In the Matter of LAWRENCE M. LABINE, Respondent.



RESPONDENT LAWRENCE M. LABINE'S

POST-HEARING REPLY BRIEF

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I. The OID is Premised on Extraordinary Extensions of the Law, a Tiny and Inconsistent Sample of Customers, and Should be Dismissed.

There are many legal errors in the case presented that warrant dismissal of the OID. First, the Division's allegations that Mr. LaBine's conduct must all be reviewed under a fiduciary duty standard suffers the flawed argument that the Division's desired legal theories can displace the limited enactments by Congress designating when a person is subject to the standards of the Investment Advisors Act. It cannot, even by Commission rule change, which the Commission also has never enacted. Mr. LaBine's conduct was that of a broker exempted from the IAA. That is not an exemption subject to challenge and the Division failed to provide evidence of fact-based fiduciary duty by presenting testimony of only five customers as to their relationship with Mr. LaBine. The allegation of failing to disclose alleged conflicts (warrants that Mr. LaBine could not count on) is predicated on that non-existent legal duty.

Additionally, the Division's case failed in its argued application of universal misstatements by not presenting anything approaching a reliable sample in either number or consistency and by alleging time sensitive claims of omissions in a request for universal findings. The Division's theory that Mr. LaBine was making material misstatements to induce sales proved untrue, with a very few clients directly claiming those statements with unbelievable claims. Rather, the few customer witnesses by and large did not support the charged theory of misstatements about loss of money or bankruptcy protection. Given that the small sample did not even agree upon those theories, the Division's argument that a universal finding may be entered cannot be entertained. More so, it may not be entered against the written warnings of risk, financial desperation, potential bankruptcy, and complete loss of principal that Mr. LaBine provided to the clients in the PPM and supplements. Rather, even if this Panel finds those

individual witnesses credible and Mr. LaBine not credible, any sanction must be reviewed as to a customer complaint, not the suggested and unproved scheme.

II. What is not Contested?

Beyond the stipulations reached between Respondent and the Division, quite a few matters in this proceeding ended up effectively agreed upon. The nature of Domin-8, both as to risk and value are not actually contested. The written materials also are not contested as to the written content, including the multitude of warnings and advisements provided for Domin-8. Similarly, the clients' written acknowledgments of having received and read those materials, and that they were acceptable also are not contested.

A. Domin-8 was a Real Product of Tremendous Value.

The evidence demonstrated that Domin-8 offered real services, owned real assets, and ultimately ended up, post-bankruptcy, a company of value at nearly $1 billion. (R.T. 1142.) It also turned out as Mr. LaBine predicted, that the Series D investors did far better than prior investors, receiving back approximately 65% or more of their investment back, paralleling market performance during the same timeframe. (Final Stipulations, at 29.) It was only an unexpected bankruptcy bid by RealPage that prevented the Series D investors from not only receiving all of their money back, but the enormous return foreseen by Mr. LaBine. (*Id.* at 1142-44.)

B. Investors Were all Warned Repeatedly That Domin-8 was High Risk, in Peril of Insolvency, and Sold With Those in the Sales Chain Receiving Both Commissions and Warrants.

It also does not appear that the Division contests the existence and content of the written offering documents provided to clients. Thus, it is not contested that from the beginning of the Series D offering, potential investors were warned that the company had only existed for a few

years, was in financial dire straits, may not ever become profitable, and if not, the investors would lose all or part of their investments. Investors were similarly warned that the entire $12 million sought was needed to operate, and even if met, might not enable the company to continue. (DV56.2; pp. 7–14). That original PPM further provided in bold:

> **An investment in the Units being offered hereby is speculative, involves a high degree of risk and should be considered only by investors who can bear the economic risk of their investment for an indefinite period and who can afford to sustain a total loss of their investment.**

(DV56.6, at 2.) It further advised that warrants would issue to the "lead placement agent," and contained no written constraints on awards of warrants to others, though it did advise on restrictions of awarding commissions:

> We are selling the Series D Debentures through the efforts of GunnAllen Financial, Inc., a NASD licensed registered broker-dealer, as lead placement agent (the **"Placement Agent"**), and our officers and directors. The Placement Agent is entitled to receive a commission of 10% of the gross proceeds raised in the Offering and to also receive a warrant to purchase a number of shares of our Common Stock determined by dividing 12% of the gross proceeds raised in the Offering by $7.00 (the exercise price for the warrants to purchase each share of Common Stock will be $7.00). See the section titled ***"Plan of Placement"*** for a more complete description of the terms of the commissions. No officer or director will receive commissions in connection with any sales made pursuant to this Memorandum.

(*Id.*)

Similarly, on October 10, 2008, Domin-8 issued Supplement No. 2 to its original PPM. (DV56.6.) Important to the claims against Mr. LaBine, the company reported that it did not have "sufficient cash to continue our operations without raising significant amounts under this Offering," and needed $2 million in October 2008, along with an additional $1 million a month until the offering was completed. The "Liquidity" section provided a detailed update of the company's dire financial situation in the deteriorating economic climate, insufficient cash flow,

and lack of assurance that it could achieve positive cash flow even with the infusion of additional financing. (*Id.*)

On December 19, 2008, the company wrote that it needed approximately $1 million a month "for the foreseeable future," from the Series D offering to meet its obligations, and that there could be "no assurance that this Offering will be successful in raising the additional money that we need to allow us to continue to operate the business." (DV56.8, p. 4.) The Supplement expressly warned, "***If we are not able to renegotiate our outstanding liabilities and restructure our capitalization, we will be unable to continue our operations and may be forced to file for bankruptcy protection***." (*Id.* at p. 6.).

Toward the end of the offering, in July 2009, Domin-8 issued an Amended PPM. (DV56.1.) The PPM repeated the warnings and information recited above. The PPM yet again disclosed the very real potential for bankruptcy without additional funding. (*Id.* at 27.)

C. Mr. LaBine's Clients Acknowledged the Suitability of and Risk Associated with Their Investments.

It also does not appear that anyone is contesting that Mr. LaBine's clients each initialed and signed acknowledgments that they received and reviewed the offering materials, which again warned of undercapitalization necessary to even operate, the danger of bankruptcy, and the potential loss of the entire investment. (Final Stipulations, 12, 31.)

III. The Division's IAA Charge is Based not on Proof, but on an Argued Change in the Law Made Through Adoption of Duties Desired by Staff.

The Division, and its much relied upon expert witness, Professor Laby, hinge the bulk of the case on the argument that Mr. LaBine, in selling Domin-8 as a broker, is subject to liability as an investment adviser. That charge, however, is legally barred as the Division predicates the claim on a desired change in the law not adopted in the Investment Advisers Act. Mr. LaBine

cannot be found to have violated the IAA and penalized for such based upon the functional equivalent of an unauthorized rule change made through the enforcement of provisions that Congress and the Commission never enacted.

A. Mr. LaBine's Sales Were Conducted as a Broker Exempted by the IAA.

The Division attempts to defeat the broker exception under which Mr. LaBine conducted sales by wrongly asserting that no dually registered representative may be exempted, and that Mr. LaBine may not be exempted because monies for sales came from advisory accounts with potential advice about Domin-8. However, the Division provides no actual authority for its broad reading that no dually registered representative may qualify for the broker exemption, nor is there any. Beyond that, Mr. LaBine did conduct the sales as an exempted broker as he received no special compensation, and certainly none for his advice other than the advice attendant the sale.

A person may qualify as an investment adviser based upon the facts and circumstances of the case, but those facts and circumstances also relate to several exceptions proscribed by Congress in the IAA. 15 USCS § 80b-2(a)(11). The relevant exception as outlined previously is for "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." 15 USCS § 80b-2(a)(11)(C). The courts have interpreted that provision to except a broker, even those receiving special compensation, so long as that compensation is not in exchange for advisory services outside the broker transaction.

The hearing established that each Domin-8 transaction was a direct purchase that could not be transacted in any of the advisory accounts of Mr. LaBine's clients. He approached each client with a product and received compensation only under the terms of the sale. Mr. LaBine

expects for the Division to argue that the significance of potential warrants somehow disqualifies that exception. However, the significance or amount of special compensation is irrelevant, as the exception only does not apply if the special compensation is for advisory services not incidental to the purchase. Courts have recently noted such in rejecting attempts to defeat the exception by claiming that special compensation is extraordinary.

> In any event, the cases demonstrate that the critical factor in determining whether a broker-dealer qualifies for the exemption is the connection of the payment to any advisory services rendered, and not the form of that payment.

Wiener v. Eaton Vance Distribs., NO. 10-10515-DPW, 2011 U.S. Dist. LEXIS 38375, at *28 (D. Mass. Mar. 30, 2011).

The Division contends that Mr. LaBine cannot claim broker status because the portfolio and diversification for some customers was discussed as part of the transaction. However, that is irrelevant for three reasons. First, it is irrelevant because the Division must show that there was special compensation for that advice *not incidental to the sale*, not simply advice itself. The only compensation for the transaction was that offered for the broker activity, a commission (or, by the Division's argument, warrants). Second, advising on the benefit of a product was still incidental. To hold otherwise would eliminate the entire exception in the IAA and worse yet, promote a practice of all brokers not having extended informational discussions with customers to bar being treated as investment advisors for their transactions. The very terms of the IAA broker exception allow for providing "such services", defined as "advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities." 15 USCS § 80b-2(a)(11)(C); *Thomas v. Metro. Life Ins. Co.*, 631 F.3d 1153, 1160 (10th Cir. 2011). Therefore, such advice as to advisability of a purchase cannot categorically exclude a broker

from qualifying as it is still advice incidental to the broker sale exempted from the IAA.[1] And third, the Division's argument again suffers from its lack of proof. If the discussion of portfolio and diversification benefits defeats the exemption, that is still a factual matter that must be proved as to each transaction. The claim of such a discussion existing and defeating the broker exception then would only apply to the two clients cited by the Division for that proposition.

The Division also attempts to eliminate discussion of the statute and the exception by citing its expert, Dr. Laby, for the conclusory statement in his rebuttal report that the exception cannot apply to a broker dually registered as a financial advisor. That fails for several reasons. First, the statute by its terms governs its application, not the subjective views of an expert who desires legal change. The IAA allows for the exception for any "broker," which under the IAA is defined as "any person engaged in the business of effecting transactions in securities for the account of others." 15 USCS § 80b-2(a)(3) (adopting the definition of "broker" from the Exchange Act, 15 USCS § 78c(a)(4)). And second, an expert is not the source of the meaning of the law, especially when that view is the unconstitutional proposition that the application of the IAA evolves according to purported industry standards. Third, Professor Laby's claims of how the IAA exception reads are irrelevant. The required showing was set forth by the court in *Thomas*, 631 F.3d at 1166-67 and courts thereafter all identically interpreting the statute.[2]

Finally, the Division's interpretation fails to square with the Commission's interpretation of the IAA in 1940 shortly after its enactment:

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[1] Additionally, the argued bar to the broker exception based on discussion of diversification would create a catch-22 whereby a broker could either not comply with the requirement of determining suitability through discussion or not qualify for the broker .exception by instead determining suitability.

[2] The Division's Post-Hearing Brief actually demonstrates the lack of authority for the categorical exclusion of dually registered representatives by citing as authority for this alleged interpretation only one enforcement proceeding and a settled matter, which necessarily is not dispositive of any merits rulings. (Br. at 66.)

> *Clause (C) of section 202 (a)(11)* amounts to a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business...

11 Fed. Reg. 10,996 (Sept. 27, 1946) (reprinting SEC General Counsel opinion letter of October 28, 1940). Conversely, any charges "directly related to the giving of advice" would be special compensation and not fall within the exemption. *Id.* The Commission's interpretation was in accordance with Congress' intent when it passed the IAA:

> " 'investment adviser' is so defined as specifically to exclude ... brokers (insofar as their advice is merely incidental to brokerage transactions for which they receive *only* brokerage commissions)."

S. REP. NO. 76-1775, at 22 (emphasis added) [HA 164] (1940); *see also* HR. REP. No. 76-2639, at 28 [HA 168] (1940).

Given that (1) Mr. LaBine received commissions for sales, not any special compensation for advice in connection with Series D; and (2) the sales of Series D could not occur in advisory accounts; and (3) were for brokerage transactions for which Mr. LaBine could only receive commissions, it is apparent that the Commission itself (nor Congress) did not intend for Mr. LaBine's sales to fall within the IAA.

B. The Division Rests on a Theory That Would Replace the Provisions of the IAA With its Internal Theories of Duties, in Contravention of Congress's Exclusive Legislative Authority.

The Division's theory that Mr. LaBine is subject to liability under the IAA requires abrogation of the IAA exemptions instead to be replaced upon an absolute treatment of all broker acts under a fiduciary duty standard whenever a broker is dually registered. That, however, is a desired legal duty of the Division, not an act of Congress. A finding of liability in violation of the

IAA would unlawfully subject Mr. LaBine to a de facto rule change in contravention of the exceptions adopted by Congress.

As outlined above, Congress adopted several express exemptions from treatment as an investment advisor subject to the terms of the IAA. The Division's arguments of liability would actually displace those exemptions to instead be replaced by a proposal of duties adopted by the Staff. That is an effective abrogation of the statute much like those rejected by the courts as amendment through interpretation. For example, the District of Columbia Court of Appeals rejected a claim of plenary authority to enact procedures by the National Mediation Board where Congress directly spoke to the issue in the statute effected by the agency action. The court found the agency procedures unauthorized and "plainly out of keeping with *Chevron*[3] and quite likely with the Constitution as well." *Ry. Labor Execs.' Ass'n v. Nat'l Mediation Bd.*, 29 F.3d 655, 671, (1994).

Much like the unauthorized rule enactments barred in *Ry. Labor Execs.' Ass'n*, the Division seeks through the act of enforcement discretion to abrogate Congress's broker exception for a more limited exception advocated by the Staff:

1) The broker symbolically switches hats in discussions with the client (whatever that is supposed to mean);

2) The dually registered broker coordinates with, not the statute, but the Division's concept of industry standards.

Moreover, the incidental nature of special compensation does not matter by the Division's argument whatsoever even though that is an express term of the broker exception.

[3] *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

Liability under those terms though would unlawfully subject brokers such as Mr. LaBine to penalties absent an actual violation of the IAA. And it would effectively amend the IAA absent an act of Congress in violation of the Separation of Powers. Such a construction of the IAA, to be displaced instead by the Division's advisory opinions and the desires of its experts, would be unlawful and also a violation of the requirements that Congress's instructions be so limited. "To read out of a statutory provision a clause setting forth a specific condition or trigger to the provision's applicability is ... an entirely unacceptable method of construing statutes." *Fin. Planning Ass'n v. SEC*, 482 F.3d 481, 488 (D.C. Cir. 2007).

Here, the Division wrongly argues that the duties imposed upon respondents and any exceptions are those identified as a mix of legal requirements and industry standards as well as any prior statements of legal interpretation by SEC staff.[4] On page 61 of the Post-Hearing Brief, the Division, through quoting Professor Laby, attempts to impose the IAA fiduciary duty requirements through argument that the Commission may be informed of legal requirements through a claim of industry standards of care. As to application of the IAA, it cannot, as the exception for brokers was expressly defined by Congress. Whatever the means sought and whatever potential laudable goals are held by the Division for limiting the broker exception, the exception adopted by Congress governs.

> The statute may be imperfect, but the Board has no power to correct flaws that it perceives in the statute it is empowered to administer. Its rulemaking power is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute.
>
> If the Bank Holding Company Act falls short of providing safeguards desirable or necessary to protect the public interest, that

[4] On page 67 at note 35, the Division argues for a broker exception only upon complying with a switching hats exercise set out in a prior published staff interpretation of the IAA. However, it is beyond question that where the Commission is not authorized by Congress to amend the broker exception, it cannot de facto amend the exception by staff interpretation.

is a problem for Congress, and not the Board or the courts, to address.

Bd. of Governors of Fed. Reserve Sys. v. Dimension Fin. Corp., 474 U.S. 361, 374 (1986).

The alleged failure to inform customers that he was acting as a broker and not a financial advisor is all based on a claim of liability under the IAA. As the IAA did not apply to these sales, that theory of misrepresentation necessarily fails.[5]

IV. The Division's Misrepresentation Claims are Predicated on Matters Expressly and Exhaustively Explained in the Offering Documents.

The Division does not address the bespeaks caution doctrine charging customers with knowledge of provided written materials. Instead, the Division asserts that there is an established doctrine rendering such disclosures meaningless against alleged misrepresentations. (Br., at 84.) However, the Division cites only one case addressing the issue, which instead holds that the inquiry about whether a misrepresentation is immaterial is fact specific. *Morgan Keegan & Co., Inc.*, 678 F.3d 1233, 1252 (11th Cir. 2012). Under established law that written warnings may directly negate even a misstatement, none of the alleged misrepresentations can be deemed material as the customers were exhaustively warned time and again about the risk and dire straits of Domin-8.[6]

Respondent already directed this Panel to the doctrine that a customer is charged with the knowledge of matters disclosed in offering documents. Quite contrary to the Division's claim that Mr. LaBine is shifting blame to his customers, he is properly relying upon the court direction holding investors accountable to disclosure documents provided to them.

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[5] This is the only theory of misrepresentation advocated as to investment customer Mealins. (Br. at 29.) Reliance upon that theory as to Mealins and any other customer must be rejected.

[6] Respondent already provided in his Post-Hearing Brief at page 34 several citations to courts in SEC actions holding that a statement or omission may be immaterial as a matter of law.

> Thus, it is our view that knowledge of information contained in a prospectus or an equivalent document authorized by statute or regulation, should be imputed to investors who fail to read such documents.

E.g., *Zobrist v. Coal-X, Inc.*, 708 F.2d 1511, 1518 (10th Cir. 1983). By way of review, even those who customers who testified that they refused to read the documents provided to them, are charged with the express statements as of the initial offering that:

- The company had a limited operating history and suffered substantial losses in 2007. (DV56.2 at 7.)
- The investment was "speculative" with risk of total loss. (*Id.* at 2.)
- The company expected to incur additional substantial losses in 2008 "until such time as the growth in revenues is sufficient to allow the Company to report quarterly net income on a consistent basis." (*Id.* at 7.)
- The company stated it could provide no assurances that it would ever become profitable, and "[i]f the Company does not become profitable, investors will lose all or part of their investment." (*Id.*)
- The "Need for Substantial Additional Financing," made it clear that the company's Maximum Offering Amount of $12 million of Series D Debentures was necessary to keep the undercapitalized company afloat. (*Id.*)
- The "Use of Proceeds; Risk of Selling Only Minimum of $5.0 Million principal Amount of Series D Debentures" warned that the company was obligated to repay Seller Notes related to a prior acquisition, and that if it failed to raise enough money in the Offering, it could not meet those obligations and have sufficient working capital. (*Id.* at 7–8.)

- Supplement No. 2 explained that, "there can be no assurance that . . . any initiatives undertaken by the Company will result in raising the remaining" funds available in the Offering. (DV56.6, at 4.)
- The company reported that it did not have "sufficient cash to continue our operations without raising significant amounts under this Offering," and needed $2 million in October 2008, along with an additional $1 million a month until the offering was completed. (*Id.* at 5.)
- Even with concurrent financing from other sources and the Series D proceeds, the company stated, *"[n]o assurance can be given that we will be able to raise the significant and regular amounts of capital necessary to satisfy our operating cash needs."* (*Id.*, emphasis added.)
- The company announced its intent to seek additional capital from multiple sources and stated that "[t]here can be no assurance that the Company will be successful in obtaining capital to support the execution of its near-term operating plans or long-term strategy." (DV56.7, at 2.)
- the company wrote that it needed approximately $1 million a month "for the foreseeable future," from the Series D offering to meet its obligations, and that there could be "no assurance that this Offering will be successful in raising the additional money that we need to allow us to continue to operate the business." (DV56.8, at 4.)
- The final supplement added, ***"If we are not able to renegotiate our outstanding liabilities and restructure our capitalization, we will be unable to continue our operations and may be forced to file for bankruptcy protection."*** (*Id.* at 6.)

The Division does not try to argue that the alleged misrepresentations by Mr. LaBine could overcome these overwhelming warnings and statements. Nor can it. Rather, Mr. LaBine is effectively charged with not verbalizing the warnings that he provided to customers in writing. By way of example, the Division alleges that the Boses did not read the offering documents and that LaBine violated a duty to tell the Boses that they could lose money and that he affirmatively misrepresented Domin-8 as "safe." (Br. at 31-32.) But, the bespeaks caution doctrine bars a claim of failing to disclose to the Boses the potential for bankruptcy that was expressly contained in the supplement to the PPM, the need for $1 million in raised capital per month to operate, and the chance of loss of all principal contained in the PPM. Courts have routinely rejected claims of misstatements covered by prospectuses such as those for Domin-8. *Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1032-33 (2nd Cir. 1993); *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371 (3rd Cir. 1993).

> While a misleading statement will not always lose its deceptive edge simply by joinder with others that are true, the true statements may discredit the other one so obviously that the risk of real deception drops to nil. Since liability under § 14(a) must rest not only on deceptiveness but materiality as well[,] . . . publishing accurate facts in a proxy statement can render a misleading statement too unimportant to ground liability.

Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1097 (1991).

Looking at the Division's claims of misrepresentation, all are directly defeated by the written record that was provided to customers. As to the Boses, the Division alleges a failure to disclose the potential of bankruptcy, the potential loss of money, and that the investment was safe. However, the Division concedes that the Boses were provided the documents that discussed bankruptcy, the speculative nature of the investment, the limited ability to even operate, continued operating debt, and that absent reaching profitability, there was a risk of loss of the

entire investment. There can be no finding of a misrepresentation when those documents are imputed to them, as required.

As to [redacted] Pettit, he testified that Mr. LaBine portrayed Domin-8 as making money. However, he also received the PPM materials, meaning he was informed that Domin-8 was in fact bleeding money, in debt, and needed cash infusions to just keep the doors open. The written documents, when viewed with basic common sense, disabused every alleged omission and misrepresentation lodged against Mr. LaBine. "We can say that the prospectus here truly bespeaks caution because, not only does the prospectus generally convey the riskiness of the investment, but its warnings and cautionary language directly address the substance of the statements the plaintiffs challenge." *Trump Casino Sec. Litig.*, 7 F.3d at 372.

V. The Division's Claim That Failure to Verbalize Possible Warrant Compensation was a Misrepresentation Reads too Narrowly the Disclosures and too Broadly Potential Conflicts.

It bears repeating that there is no evidence of *anyone* granting or receiving warrants in connection with Series D, whether affiliated with Domin-8, GunnAllen, DeWaay or any other seller. Perhaps to mask its concerns that its remaining misrepresentation claims are lacking, the Division continues to press arguments about something that never happened: Mr. LaBine never received any warrants nor any assurances that he would. All he did was ask one question in one email, and he never received an answer from DeWaay, which controlled the warrants pursuant to its Selling Agreement with GunnAllen. (DV 16, 17; R17.) In essence, the Division asks the Commission to accept the notion that Mr. LaBine had an obligation to disclose that he received no response or promise in connection with an inquiry about something to which he was not entitled. Even securities laws are not that flexible as it expands the concept of liability based on potential into the realm of liability if a request is not absolutely foreclosed forever.

The Division also offers no counter for the undisputed evidence that Mr. LaBine sold virtually an identical amount of Series D both before and after his November 2008 inquiry. (Final Stipulations, at Table 1; DV 101.02, Demonstrative F.) This destroys the notion that Mr. LaBine's sales were motivated and consumed by the prospect of warrants. Had that been the case, he would have inquired before making any sales.

The Division advances three arguments to claim that an inquiry about warrants as part of sales of Series D without express disclosure of such created material misrepresentations or omissions. First, the Division argues that the disclosures provided to all customers could not apprise them of the potential for warrants issuing to anyone other than GunnAllen. Second, the Division puts forth no standard of proof for an alleged mandate to disclose any potential conflict of interest. And third, as a substitute for proving materiality, the Division instead posits that the testimony of three customers that they would want to hear about warrant compensation equates proof of materiality. The Division's arguments are unavailing.

The PPM, which included DeWaay next to GunnAllen on its first page, referred to GunnAllen as the "lead placement agent" and "Placement Agent." (Div. Ex. 56.2, at 1-2.) Implicit in that first disclosure was that other entities or persons would be also treated as placement agents given that GunnAllen took the title "lead." Similarly, that paragraph stated that no officer or director of Domin-8 would receive commissions in connection with the offering, but remained silent as to receipt of warrants. Thus, within just a few sentences the PPM also acknowledged that limitations on compensation related to only commissions, not warrants.

The Division seeks to hold Mr. LaBine liable for not expressing that he inquired about but had not been promised warrants even as the PPM left open for investors that an entire unlisted category of people might also receive warrants. That was a common sense reading of the

PPM, which all customers must be held to. *Parnes v. Gateway 2000*, 122 F.3d 539, 549 (8th Cir. 1997).

To prove materiality, the Division cites the testimony of Pettit, Brabender, Sheen and Spaid that they would question impartiality based upon information about the warrants. (RT 74.) That, however, is not the test for materiality. Rather, the test is an objective test of an item within the "total mix" of information about the investment and whether the item would have a significant effect on the mix. "[T]here must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Tsc Indus. v. Northway*, 426 U.S. 438, 449 (1976). The testifying customers each testified that had they read the PPM as required, they would not have invested in Domin-8. That renders the warrant issue a nullity as all information in the PPM about speculative investments, risk of total loss, the need for immense infusions of cash to operate weekly, must be imputed to each of those witnesses. Standing alone, Mr. LaBine's inquiry about warrants is immaterial because all of these client witnesses testified they would not have invested if they had bothered to read the PPM. And finally, Mr. LaBine's inquiry about warrants that was connected neither to the promise or receipt of warrants cannot be considered something that could have possibly altered the total mix of information, and was therefore immaterial. *SEC v. Merch. Capital, LLC*, 483 F.3d 747, 766-68 (11th Cir. 2007); *SEC v. Patel,* 2009 U.S. Dist. LEXIS 90558 (N.H.); *SEC v. Thielbar,* 2007 U.S. Dist. LEXIS 72986 (S.D.).

The Division's attempts to extend the bound of securities law fail to provide an outer limit. Is non-disclosure of a mere inquiry and the speculative possibility of receipt of warrants

enough?[7] Such a regime would create liability upon no set standards for men or women of ordinary intelligence to predict and would violate Mr. Labine's due process rights to some certainty as to application of a penalty statute upon which to conform his conduct.

The Commission must dismiss any claims related to Domin-8 warrants.

VI. The Entire Record Demonstrates That Mr. LaBine did not act With Scienter.

The record demonstrates that the Division failed to demonstrate the intent or recklessness alleged by the Division. There was no intent to defraud, especially where Mr. LaBine provided written materials covering the alleged misrepresentations. Those materials negate even a suggestion of misrepresentation regarding whether Domin-8 was safe, completely protected by bankruptcy, financially solvent or the like.

To repeat, the Division alleges misrepresentation by omission for matters about Domin-8 that Mr. LaBine provided to each customer in written form. Thus, as to a warning about bankruptcy and potential loss of the investment, Mr. LaBine did provide those warnings in written form. Those are non-issues.

As to warrants, the Division asserts that Mr. LaBine expected warrants and operated with scienter because he aggressively sold Domin-8. However, Mr. LaBine aggressively sold Domin-8 in 2008, prior to any email inquiries about warrant compensation. The Division suggests an intent based on the prospect of warrants motivating Mr. LaBine. There are two faults with that argument. First, a demonstration of intent must be an intent to "deceive, manipulate, or defraud." *Ernst & Ernst v. Hockfelder*, 425 U.S. 185, 194, n. 12 (1976). And second, motivation is not a substitute for the aim of the underlying conduct, and the Division did not present evidence that

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[7] The Judge noted the fault with this undefined concept of conflict by questioning whether all sales contests then must be disclosed. (RT 38-39.) Tellingly, the Division responded by claiming that investment advisor representatives, as opposed to brokers, must disclose everything. (*Id.* at 39.) That hinged their theory to the Investment Advisors Act, which does not apply.

Mr. LaBine ever received any assurance of warrants. Instead, the Division asserts that the prospect of warrants was real because Mr. LaBine eventually made assurances of funding to Domin-8 and increased those assurances. However, that implies evil motive where good motive is also demonstrated. Mr. LaBine believed in Domin-8 and had clients invested. (RT 381-384, 409-10, 411-13, 965-66, 980, 999, 1052, 1129.) So, where the Division asserts that fund-raising efforts represent intent, those efforts just as well represent protecting the investors. For instance, the Division cites as proof Mr. LaBine's pledge to raise $1 million each month. However, that was timed with Domin-8's disclosure that it needed to raise $1 million each month to continue. "Reckless conduct must be something more egregious than even 'white heart/empty head' good faith." *Securities and Ex. Com. v. Rubera*, 350 F.3d 1084, 1094 (9th Cir. 2003).[8]

VII. The Charges Against Mr. LaBine Suffer in Trying to Universalize Claims Absent Factual Proof.

Even if the Commission found that a specific omission of a verbal disclosure did violate one of the charged violations, such a finding cannot be universalized as argued by the Division. The Division alleges that specific events, such as Mr. LaBine's small time period as the remaining and exclusive fundraiser required disclosure. The problem with that argument though, is that the Division argues that such an alleged violation supports a finding of violations as to all customers before that discrete time period. Effectively, that is an argument of legal liability without proof or fault.[9] Similarly, to contravene certain matters such as the effect of the offering documents as to making disclosures, the Division claims that the issue is an issue of fact, which

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[8] As discussed at pages 41 and 42 of the Opening Brief the Division has not proven negligence.

[9] The Division also refers to other filed actions that, in some part, included Domin-8. (Div. Brief, at 47-48.) Respondent trusts that this Panel will continue to ignore those allegations as any form of proof. "I agree with counsel that the allegations should not be given any weight in this proceeding." (RT 859.)

ignores that only five customers testified leaving no proof of this factual issue as to one-hundred customers upon whom the Division claims statutory frauds.

As stated above and in the Division's Pre-Hearing Brief, the Division alleged three separate matters that allegedly amounted to material misstatements or omissions. As to several already outlined above, those matters were exhaustively covered in writing. As to others, those were allegations of non-disclosure during a discrete time period and may not be universalized to all Domin-8 sales.

The Division asserts a material omission by Mr. LaBine in not disclosing that he made funding commitments to Domin-8 or became the exclusive representative. However, by the Division's own acknowledgment, "LaBine first made specific funding commitments in January 2009." (Br. at 19.) Therefore, the claim of a material omission of that fact cannot be made for sales prior to January 2009. Similarly, by the Division's own acknowledgment, Mr. LaBine did not become exclusive in his sales until sometime after April 27, 2009. (RT 921-22.) Thus, that cannot be treated as a material omission for any date earlier than April 27, 2009.

VIII. Sanctions are not Warranted, and Even if Entered, may not be Entered for Speculation About Ninety Percent of Mr. LaBine's Customers or for Dates not Covered by any Evidence.

Related to the above, the Division decided to provide an extraordinarily small number of the customers purchasing Domin-8 in support of the claims. However, that small group did not even testify consistently with the various allegations of universal statements and misstatements the Division alleges against Mr. LaBine. Thus, the Division failed in proof of the universal violations as to Domin-8. And, if this Panel does choose to credit those few claims, sanctions may only be entered based upon the specific customer. Similarly, disgorgement cannot be ordered for all Domin-8 sales, as the Division presented inconsistent testimony in support of

alleged misrepresentations from five customers. An inconsistent group of 5 out of 100 cannot be the basis for reasonable approximation.

A. The few Testifying Customers Largely did not Corroborate the Division's Theories of Universal Wrongdoing.

This Panel heard from very few investors. What this Panel did hear is that, for several of the Division's theories of affirmative misstatements, only one or two witnesses would corroborate the theory. For example, as to the allegations of misrepresentations about bankruptcy, the Division relies upon an allegation from ████ Pettit that Mr. LaBine told him in bankruptcy he would get most of his money back. But, this is all meant to prove the Division's theories that Mr. LaBine allegedly universally misrepresented that customers would get all of their money back in a bankruptcy. The only witnesses corroborating the allegation that Mr. LaBine misrepresented a full return of fund upon bankruptcy were the Sheens. In contrast, Mr. Cohen and Mr. Andries testified that Mr. LaBine discussed the possibility of bankruptcy, but made no assurances of recovery of principal. (RT 1537-42, 1591-94.) Thus, the Division failed in their global claim that Mr. LaBine misrepresented a full return of principal in bankruptcy and instead presented one such witness against two contrary witnesses. Instead, the Division suggests that Mr. LaBine necessarily must have made this misrepresentation because he privately thought that investors "should" be protected by their senior status. Such speculation though cannot substitute for proof, especially where investors negated that allegation. This fatal flaw in the few witnesses testifying as to alleged misrepresentations applies equally to the claim that Mr. LaBine misrepresented Domin-8 as safe.

B. Sanctions are not Appropriate Given the Totality of This Case.

The Division's case relies upon the insinuation of express misrepresentations made to all customers and a violation of the IAA. Neither theory was proved. Moreover, Mr. LaBine's total

behaviors demonstrate that he was looking out for his clients and that a lesser penalty is appropriate if the Commission determines to enter an order against Mr. LaBine. Mr. LaBine only began selling the Series D debentures after personally meeting with Domin-8 decision makers. He made the determination to sell the debentures after receiving favorable information from them and reviewing that Series D offered protection in its senior status. Even as Domin-8 unfortunately began to crumble, Mr. LaBine was communicating with the company to push for continued interest payments to the Series D holders. Both the Division and this Panel have acknowledged that the claims regard statements and not the viability of the Domin-8 product. "As I've indicated before, the Division has not brought a suitability case. We take no position on whether Domin-8 was a good investment prospect." (RT 784.)

C. Disgorgement Under a Reasonable Approximation Theory Cannot be Imposed on This Disparate and Minute Sample of Clients.

The Division requests disgorgement for every sale of Domin-8 by Mr. LaBine, with a high percentage of sales occurring in 2008, before the discussions about Mr. LaBine receiving warrants that the Division relies upon and before Mr. LaBine made any alleged commitments to raise funds. However, the Division put forth only a very few investors, who did not agree with each other about alleged, specific misrepresentations. On that small sample size, even if this Panel did find some alleged pattern of misrepresentation, a finding of reasonable approximation cannot be made as to all sales, especially with the bulk of sales occurring in 2008. The Division posits its argument for disgorgement backward by suggestion "it is possible that some clients would have purchased Domin-8 debentures even if LaBine had . . . not misrepresented the risk." (Resp. Brief, at 89.) But it was the division that failed to prove a misrepresentation of risk. Rather, just a few witnesses lodged that claim, and the Commission cannot issue orders based on

possibilities. Absent some form of more global proof, the Division is requesting a substitute of speculation for approximation in requesting full disgorgement.[10]

IX. Conclusion.

The Division has not proven its case and the OIP must be dismissed.

RESPECTFULLY SUBMITTED this 17 day of November, 2015.

BASKIN RICHARDS PLC

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ORIGINAL and three copies of the foregoing sent via Overnight Mail and one copy faxed this 17th day of November, 2015 to:

Kevin O'Neill (202-772-9324)
Deputy Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-2257

COPY of the foregoing sent via Electronic and Regular U.S. Mail this 17th day of November, 2015 to:

Duane K. Thompson (thompsond@sec.gov)
Assistant Chief Litigation Counsel

[10] Given that the Division does not challenge Mr. LaBine's inability to pay any financial consequences, this matter will likely prove moot as this Panel is authorized to waive both a financial penalty and disgorgement. (Resp. Brief, at 56-7.)

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