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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING

File No. 3-16175

In the Matter of

Kenneth C. Meissner, James Doug Scott, and Mark S. "Mike" Tomich,

Respondents.

DIVISION OF ENFORCEMENT'S BRIEF ON SANCTIONS AGAINST JAMES DOUG SCOTT

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The Division of Enforcement (Division) submits this additional brief in support its claim that Respondent James Doug Scott (Scott) willfully violated the broker registration provision of Section 15(a)(1) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78o(a)(1), and should be sanctioned. The Division requests a cease-and-desist order, a full associational bar, including a penny stock bar, disgorgement and prejudgment interest, and a civil penalty of $97,500.

The Court previously found that there is no genuine issue of material fact as to liability and that Scott violated Section 15(a)(1) of the Exchange Act. *See Kenneth C. Meissner*, Admin. Proc. Rulings Release No. 2376 at 3 (Mar. 3, 2015). In addition, the Court found that it was prepared to issue a cease-and-desist order, full associational bar, and disgorgement of $26,297.84 and prejudgment interest of $2,294.22 (subject to a finding that the Respondent was unable to pay) and a first-tier civil penalty. *Id.* The only issue of material fact remaining is Scott's state of mind, and therefore any appropriate sanction. *See Kenneth C. Meissner*, Admin. Proc. Rulings Release No. 2716 (May 22, 2015). The parties jointly stipulated that this issue could be resolved, without a hearing, on the briefs and evidence[1] submitted by the Division and Scott on the motion for summary disposition and this additional briefing. *See* Stipulation dated June 23, 2015.

In 2011, Gary Snisky (Snisky) recruited Scott to solicit financial advisors to sell the securities of Arete LLC. Ex. 53 at 7-8; Ex. 1 at 132-136; 145-47. Between approximately August 2011 and January 2013, Snisky received approximately $4.2 million in investor money that was supposed to be invested in Ginnie Mae bonds. Ex. 53 at 12. However, Snisky did not use any of this money to purchase bonds. *Id.* Scott, who had been previously sanctioned twice and barred from acting as a broker, recruited three advisors who induced thirteen investors to invest $1,466,992

[1] The Division submitted 68 exhibits with its previous briefs on the motion for summary disposition including the sworn investigative testimony of Scott on December 10, 2013 (referred to as Ex. 1). In addition, the Division submitted declarations of Kerry Matticks on the calculation of disgorgement and prejudgment interest.

with Arete. Scott received transaction-based compensation for each of thirteen investments. Investors lost more than half their funds, and would have lost more but for a forfeiture action against Snisky. Scott's deliberate or reckless disregard of the requirement to be registered as a broker warrants substantial civil penalties and is necessary to deter further violations.

I. An order for civil penalties is appropriate against Scott.

Under Section 21B(a)(1) of the Exchange Act and Section 9(d)(1) of the Investment Company Act of 1940, the Commission may impose a civil money penalty if a respondent willfully violated any provision of the Exchange Act, and if such penalty is in the public interest. 15 U.S.C. §§ 78u-2(a)(1), 80a-9(d)(1). A three-tier system establishes the maximum civil money penalty that may be imposed for each violation. 15 U.S.C. §§ 78u-2(b), 80a-9(d)(2). The maximum first-tier penalty for each violative act or omission is $7,500 for a natural person. 15 U.S.C. §§ 78u-2(b)(1), 80a-9(d)(2)(A) as adjusted by 17 C.F.R. § 201.1004, Table 4 to Subpt. E for conduct occurring after March 3, 2009. The maximum second-tier penalty is $75,000 for each violative act or omission if the respondent's misconduct involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. 15 U.S.C. §§ 78u-2(b)(2), 80a-9(d)(2)(B); 17 C.F.R. § 201.1004, Table 4 to Subpt. E. Civil money penalties are necessary, in addition to disgorgement, for the deterrence of securities law violations. *E.g. SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 17 (D.D.C. 1998). The amount of penalty may be determined by multiplying the penalty amount by the number of investors who actually sent money for investment. *Id.* at 17, n.15.

Scott willfully violated Exchange Act Section 15(a)(1) when thirteen investors sent funds to Arete for which he received transaction-based compensation. The Division requests entry of thirteen, first-tier penalties of $7,500 each for a total penalty of $97,500, or alternatively, a

second-tier penalty of $75,000 because the evidence demonstrates that Scott violated Section 15(a)(1) with deliberate or reckless disregard of the regulatory requirement.

A. Scott willfully violated Section 15(a) of the Exchange Act.

Scott willfully violated Section 15(a) of the Exchange Act when he offered the Arete investment to at least eight insurance salesmen or financial advisers, and induced Mark S. "Mike" Tomich, Kenneth Meissner, and Bill Sparkman to sell Arete securities to their clients. *See* Division's Motion for Summary Disposition (Motion) at 1, 11-13; Ex. 1 at 169:20-173:23. It is undisputed that Scott spoke with potential salesmen by telephone, disseminated Arete's private placement memorandum and Forms D by email, and travelled to Colorado from Pennsylvania to attend Snisky's training sessions with the salesmen. Motion at 6-7, n.28; 9, n.40, 11-12.

It is also undisputed that Tomich, Meissner and Sparkman induced at least thirteen investors to purchase $1,466,992 of the securities of Arete. Tomich solicited seven clients to invest $969,848 in Arete; Meissner solicited four clients to invest $355,242 in Arete; and Sparkman solicited two of his clients to invest $141,902 in Arete. Motion at 14 n.81, 82 & 84; *see also* Matticks Decl. dated Jan. 30, 2015 at ¶ 12. Scott participated in key points of the securities transactions by providing private placement memoranda to the salesmen, reviewing the investors' investment applications sent by the salesmen to determine if the investors were accredited investors, and confirming the transfer of investors' funds to Arete. Motion at 21; *see also* Ex. 1 at 132:14-136:22, 188:13-191:25; 204:18-205:7; Ex. 16 at 4.

Most significantly, Scott does not dispute that he received transaction-based compensation from Snisky and his entities for the sales made by Tomich, Meissner and Sparkman, and then paid commissions to the salesmen sending funds across state lines. Motion at 29. Transaction-based compensation means "compensation tied to the successful completion of a securities transaction."

Order Exempting the Fed. Reserve Bank of NY, Maiden Lane LLC and the Maiden Lane Commercial Mortg. Backed Sec. Trust 2008-1 from Broker-Dealer Registration, Exchange Act Rel. No. 61884, 2010 WL 1419216, at *2 (Apr. 9, 2010). Snisky and his entities made nine wire transfers totaling $95,595.94 to Scott corresponding to Arete's receipt of funds from the thirteen investors. Matticks Decl. at ¶ 13. Out of those funds, Scott paid commissions totaling $67,476.60 to Tomich, Meissner, and Sparkman, and fees of $1,457.50 to Summit Trust. *Id.* at ¶ 16. Scott retained $26,297.84 in commissions. *Id.* at ¶ 17; Motion at 15.

It is also undisputed that Scott was not registered as a broker-dealer or associated with a registered broker-dealer at any relevant time.[2]

To commit a willful violation, a respondent does not need to intend to violate the law, but merely intend to do the act that constitutes a violation of the law. *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). Scott's actions were unquestionably willful because he affirmatively acted as a broker by inducing salesmen to sell Arete investments, reviewing investors' applications to determine if they were accredited, confirming the transfer of investors' funds, and receiving transaction-based compensation which he split with the salesmen. These facts establish Scott violated Section 15(a) on at least thirteen occasions.

B. Public Interest

When considering whether a sanction serves the public interest, the Commission considers the factors identified in *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981): the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of his or

[2] Scott Answer at ¶ 4.

her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations *(Steadman* factors). *See Altman v. SEC,* 666 F.3d 1322, 1329 (D.C. Cir. 2011); *Gary M. Kornman,* Exchange Act Release No. 59403, 2009 SEC LEXIS 367, at *22 (Feb. 13, *2009), pet. denied,* 592 F.3d 173 (D.C. Cir. 2010). Other factors the Commission considers include the age of the violation (*Marshall E. Melton,* 56 S.E.C. 695, 698 (2003)), the degree of harm to investors and the marketplace resulting from the violation (*id.*), the extent to which the sanction will have a deterrent effect (*see Schield Mgmt. Co.,* 58 S.E.C. 1197, 1217-18 & n.46 (2006)), whether there is a reasonable likelihood of violations in the future (*KPMG Peat Marwick LLP,* 54 S.E.C. 1135, 1185 (2001), *pet. denied,* 289 F.3d 109 (D.C. Cir. 2002)), and the combination of sanctions against the respondent (*id.* at 1192). The Commission weighs these factors in light of the entire record, and no one factor is dispositive. *KPMG Peat Marwick LLP,* 54 S.E.C. at 1192; *see Gary M. Kornman,* 2009 SEC LEXIS 367, at *22.

1. **Scott's violations were not isolated.** Scott committed multiple violations of Section 15(a) of the Exchange Act in 2012. He attempted to induce at least eight insurance salesmen or financial advisers to offer Arete's securities to their clients, and persuaded three of them, Tomich, Meissner and Sparkman, to solicit at least thirteen investors who purchased investments in Arete. Scott's violations were recurrent occurring from at least April through October 2012. Matticks Decl. at ¶ 3, 5, 7, 9. Scott's violations followed a pattern of selling unregistered securities while he is not registered as a broker. *See* Penn. Sec. Com. Orders, Ex. 9.

2. **Scott acted with scienter.** Although violations of Section 15(a) of the Exchange Act are based on strict liability and scienter need not be proved, *see SEC v. Martino*, 255 F. Supp. 2d 268, 283 (S.D.N.Y. 2003); *SEC v. Nat'l Exec. Planners, Ltd.*, 503 F. Supp. 1066, 1073 (M.D.N.C. 1980); Scott acted with scienter. Scott asserts that he did not know that he was selling

securities. However, Scott knew from his discussions with Snisky that he was offering investments in a program in which investors' funds were pooled into one account to purchase Ginnie Mae bonds or other "Agency Bonds" that were to provide interest to investors. Motion at 6; Ex.1 at 148:2-156:20; 157:6-159:17, 168:7-170:10; Ex. 13 and Ex. 12 at 1. In addition, Scott knew from the disclosures in Arete's private placement memorandum (PPM) that the Arete investments were unregistered "Securities," used to purchase "Agency Bonds," and were offered by Arete, which was not a "United States Securities Dealer or Broker or US Advisor." Motion at 7; Ex. 1 at 11:5-12:3, 188:13-191:25; Ex. 12 and Ex. 16 at 1, 3. Furthermore, Scott distributed to the salesmen copies of Arete's Forms D, which disclose at the top of the forms that it is a "Notice of Exempt Offering of Securities." Motion at 8-9, n.40 & n.41, Ex. 18 & 19. While Scott claims not to be an expert on Regulation D, he knew that Arete's investments could only be offered to accredited investors, and he reviewed the investors' applications to determine if they were accredited. Ex. 1 at 133:2-134:23; 204:18-25.

Snisky's disclosures to Scott in the PPM and Forms D demonstrate that Scott was at best willfully blind to the nature of the investments he offered, and that he must have known he was selling securities. *See John P. Flannery*, Securities Act Release No. 9689, 2014 SEC LEXIS 4994, at *28 n.24, 2014 WL 7145625, at *10 n.24 (Dec. 15, 2014) (defining "extreme recklessness" in the context of securities fraud as including highly unreasonable conduct where the danger of violations was so obvious that the respondent must have known of it).

3. Scott does not recognize the wrongfulness of his acts. Scott knew that he had been previously ordered by the Pennsylvania Securities Commission to cease and desist from selling securities in Pennsylvania in 1999, and subsequently barred from being registered as a broker-dealer or investment adviser in 2005. Ex.1 at 36-39; Ex. 9. Yet when he began to offer

the Arete investments, Scott did not take steps to determine if he was selling securities or should be registered as a broker. Scott's only purported due diligence was to conduct a Google search on Snisky. Ex. 1 at 36:24-38:10; 161:16-163:15. Scott frequently interacted with attorneys in offering the services of Summit Trust, but he did not retain one to advise him whether Arete's interests were securities or if he needed to be registered as a broker to sell them. *See, e.g.*, Ex. 1 at 44:14-45:14; 54:3-24; 107:7-21; 111:17-113:7; 127:4-128:1; 130:11-131:4; 185:9-22.

Scott provides no assurances against future violations or that he recognizes the wrongful nature of his conduct. Scott's bare denial[3] that he did not believe an investment in Arete was a "security" does not establish a genuine issue of material fact. *Jay T. Comeaux*, 2014 WL 4160054, at *2 (a party opposing summary disposition "may not rely on bare allegations or denials"). Rather the evidence establishes Scott was willfully blind to the disclosures by Snisky that the investments in Arete were securities. Scott's denial is not credible in light of the information and the offering materials that Scott received from Snisky disclosing the interests in Arete were securities.

4. Scott's employment creates opportunities for future violations. Since at least 1998, Scott has engaged in sales of securities while he was not registered as a broker. *See* Ex. 9 at 5. Scott continues to sell insurance, Ex. 1 at 33:23-35:5, and will continue to have the same opportunities to sell securities as he did when he sold Arete; his occupation clearly presents opportunities for future violations. In addition, there is a strong likelihood of violations in the future because Scott offered investments in Arete in flagrant disregard of Pennsylvania's orders prohibiting him from selling securities or acting as an unregistered broker. These violations are relatively recent, there is considerable evidence of harm to investors directly resulting from the

[3] Scott Answer at ¶¶ 2, 4, 17.

violations, and sanctions are necessary to have a deterrent effect. Considering all of the *Steadman* factors, entry of sanctions against Scott is in the public interest.

C. Scott acted in deliberate or reckless disregard of a regulatory requirement that he be registered as a broker to sell investments.

Scott acted in deliberate or reckless disregard of the regulatory requirement that he must be registered as a broker to sell Arete's investments. Scott admitted that he was sanctioned by the Pennsylvania Securities Commission, first being ordered to cease and desist from selling unregistered securities in 1999, and then barred in 2005 from acting as a broker. Ex. 1 at 36-38. He also admits that he received and read Arete's PPM which clearly stated that the Arete interests were "Securities" and the investments were used to purchase "Agency Bonds." *See* Ex.1 at 191-94; Ex. 16 at 1, 3. Scott knew that a compliance officer at Summit Trust objected to the use of Summit's name on the PPM, because they were not offering the securities. Ex. 1 at 192-94. In addition, Scott requested Arete's Forms D, which he sent to the salesmen, and checked investors' forms to confirm they were accredited investors. Ex. 18 and 19; Ex. 1 at 132:14-134:23; 204:18-25. Scott's protestation that he did not know that "Mr. Snisky's program would be considered a 'security' or [he] would have had nothing to do with it" is a bare denial that should be given no weight. *See* Scott Answer at ¶ 2, 4, 17; *Jay T Comeaux,* 2014 WL 4160054, at *2. The evidence demonstrates that Scott was at best willfully blind to the fact he was selling securities, and more likely, based on the disclosures in the PPM and Forms D, deliberately disregarded that he was selling securities when he was not registered as a broker. Accordingly, Scott acted in deliberate or reckless disregard of the regulatory requirement and should receive a second-tier penalty.

II. Civil penalties of $97,500 are appropriate against Scott.

Scott induced Tomich, Meissner and Sparkman to solicit thirteen investors to purchase interests in Arete, for which Scott received transaction-based compensation of $95,595.94. He

paid $67,476.60 to the salesmen and retained $26,297.84. Each of the thirteen sales is a separate violation of the broker registration requirement, for which a penalty should be assessed against Scott. *E.g. Kenton Capital,* 69 F. Supp. 2d at 17, n.15. The Commission should impose thirteen, first-tier penalties of $7,500 each against Scott for a total penalty of $97,500 under 15 U.S.C. §§ 78u-2(b)(1) and 80a-9(d)(2)(A). This monetary penalty is warranted because Scott ignored two previous orders to cease and desist from selling unregistered securities and barring him from acting as a broker or investment advisor. Entry of a similar sanction in this case to cease and desist without a monetary penalty is not in the public interest because it will have no deterrent effect on Scott, who ignored the previous orders prohibiting this conduct. Scott's actions resulted in substantial losses; the thirteen investors lost approximately half of their $1,466,992 investment. Motion at 25, n.119. Civil penalties of $97,500 are in the public interest and necessary, in addition to the cease-and-desist order and associational bar, to deter Scott from future violations because he ignored previous the cease-and-desist, and bar orders.

Alternatively, the Division requests that the Commission impose a second-tier penalty of at least $75,000 against Scott based on his deliberate or reckless disregard of the regulatory requirement that he be registered as a broker when he offered the securities of Arete. Scott knew from the Pennsylvania Securities Commission orders entered against him that he must be registered as a broker to sell securities. Scott also knew that Snisky disclosed that the interests in Arete were "Securities" in the Arete PPM and Forms D that Scott received and read. Scott did no due diligence to determine whether the interests in Arete were securities or whether he could offer them without registering as a broker. Scott's protestation that he did not know Arete's interests were a security is simply willful blindness and supports a finding that he acted with reckless disregard of the requirement to register as a broker. *Kenneth C. Meissner*, Initial Decision Release

No. 768 at 9 (April 7, 2015). The Commission could impose thirteen, second-tier penalties resulting in a total of $975,000. But when all the *Steadman* factors are considered, a second-tier penalty of at least $75,000 is appropriate for Scott's violations.

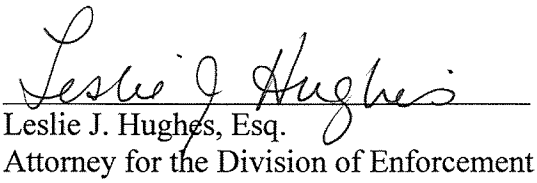
As discussed in the Division's Reply in Support of Motion for Summary Disposition against James Doug Scott (Reply), the Court should give little credence to Scott's claimed inability to pay a civil penalty. Reply at 5-7. Scott has structured his finances to appear judgment proof. He previously [redacted], Ex.1 at 37:5-24, and structured the Cromarty Group to be held [redacted] Ex. 1 at 15:5-18:25. Moreover, Scott and his wife have a net worth of [redacted], which is sufficient to pay full disgorgement of $26,297.84, prejudgment interest of $2,294.22, and a civil penalty of either $97,500 or $75,000. In addition, Scott under reported his income in his sworn financial statement. Reply at 10. Accordingly, it is in the public interest to order Scott to pay full disgorgement and a civil penalty. Even if the Court considers Scott's claim of inability to pay, "[n]othing in the securities laws expressly prohibits a court from imposing penalties or disgorgement liability in excess of a violator's ability to pay." *SEC v. Brown*, 658 F.3d 858, 861 (8th Cir. 2011). Scott's conduct warrants a substantial civil penalty.

III. Conclusion

The integrity of the financial markets is dependent on registered brokers offering securities. Scott's total disregard of this regulatory requirement assisted Snisky in perpetrating a fraud on investors who lost more than half of their investments. Scott is a recidivist acting in defiance of two Pennsylvania Securities Commission orders to cease and desist from selling unregistered securities and barring him from acting as a broker. Scott's conduct demonstrates that a substantial civil penalty of $97,500 is necessary to deter him from further violations.

Dated July 10, 2015.

Respectfully submitted,



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CERTIFICATE OF SERVICE

On July 10, 2015, the foregoing DIVISION OF ENFORCEMENT'S BRIEF ON SANCTIONS AGAINST JAMES DOUG SCOTT was sent to the following parties and other persons entitled to notice as follows:

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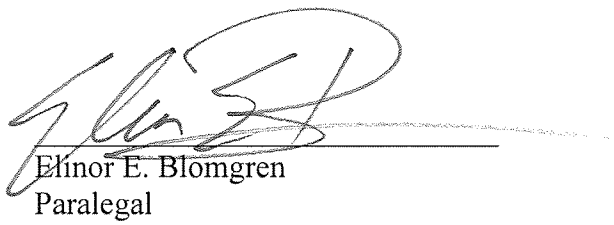

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