UNITED STATES OF AMERICA
Before The
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16182

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In the Matter of,

PAUL EDWARD "Ed" LLOYD, JR., CPA,

Respondent.

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RESPONDENT'S POST-HEARING BRIEF

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Respondent, Paul Edward "Ed" Lloyd, Jr., CPA, ("Mr. Lloyd") by and through his counsel, Sharpless & Stavola, PA, respectfully submits this Post Hearing Brief.

On September 30, 2014, the Securities and Exchange Commission ("SEC") filed an Order Instituting Proceedings ("OIP") against Respondent alleging violations of Section 17(a) of the Securities Act of 1933; Section 10(b) of the Securities Exchange Act of 1934; Sections 206(1), 206(2), 206(4); and Rule 206(4)-8 of the Investment Advisers Act of 1940 ("Advisers Act"). The OIP provided that a public hearing would be convened before an administrative law judge "to be designated by further order as provided by Rule 110 of the Commission's Rules of Practices, 17 C.F.R. § 201.110." (OIP Section IV.)

On February 27, 2014, ALJ Carol Fox Foelak ("ALJ Foelak") partially granted and partially denied Respondent's Motion for Summary Disposition and ordered that limited issues would be examined during the hearing. Specifically, the hearing would not address the Division's allegations of violations of Securities Act Section 17(a); Exchange Act Sections 10(b) and 15(a) and Rule 10b-5; and Advisers Act Rule 206(4) in connection with any of the Forest Conservation entities. *Paul Edward "Ed" Lloyd, Jr., CPA*, Admin. Proc. Rulings Release No. 2366, 2015 SEC (Feb. 27, 2015). The only questions to be examined at hearing were the Respondent's alleged violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act, and only in connection with Forest Conservation 2012, LLC ("FC 2012").

After the Order on Summary Disposition and an Order dated March 12, 2015, allowing Respondent's expert report to be received in evidence and providing that cross examination of the expert could be accomplished by videoconference or telephone, the Commission, with no explanation, and on the day the hearing was to begin (March 16, 2015) caused an unsigned "order" of Brenda Murray, Chief Administrative Law Judge, to be recorded. The order, without explanation, removed ALJFoelak from the case and designated Cameron Elliot as Administrative Law Judge.

On March 19-20 and 23-25, 2015, ALJ Cameron Elliot ("ALJ Elliot") presided over a hearing pursuant to Commission Rules 300-360 ("Hearing").

PRELIMINARY STATEMENT

The Division failed to carry its burden of proving the violations of the Advisers Act Sections 206(1), 206(2), and 206(4) regarding FC 2012, LLC during the hearing. Mr. Lloyd did not act as an investment adviser with respect to the only transaction at issue but as an accountant.

FACTUAL BACKGROUND ESTABLISHED AT HEARING

The allegations at issue after ALJ Foelak's February 27, 2015 Order include violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act in connection with FC 2012. A brief review of the facts established during the trial regarding FC 2012 follows.

I. EVENTS PRIOR TO FC 2012

Paul Edward "Ed" Lloyd, Jr. ("Ed Lloyd" or "Mr. Lloyd") is a certified public accountant and as a CPA provides tax guidance to his clients. (Lloyd 692:23-24; 694:15-695:8.) He owns and operates Ed Lloyd & Associates, PLLC where he offers tax planning and preparation services. (Lloyd 692:25-695:4.)

Mr. Lloyd learned of the conservation easement tax planning technique at a tax seminar from a conservation easement specialist, Nancy Zak. Ms. Zak was also a registered representative for Strategic Financial Alliance, Inc. ("SFA"), (Zak 98:11-23) which was in the business of offering ownership units in entities owning real estate in which a conservation easement would be donated and a large tax deduction secured. *See* Admin. Proc. Rulings Release No. 2366. He contacted Ms. Zak in 2011 to obtain a better understanding of the process. (Lloyd 767:2-769:12.) After speaking with Ms. Zak, Mr. Lloyd first offered the conservation easement to his clients in 2011. In 2012, Mr. Lloyd offered another conservation easement to his clients.[1] (Lloyd 761:18-762:8.) The 2011 conservation easement transaction is not at issue in this matter.

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[1] From 2006 through 2013 legislation allowed a taxpayer a deduction of up to 50% of adjusted gross income for qualified conservation easements. That special provision has now expired, and the deduction for a donation of a conservation easement is now limited to 30% of AGI, as with other charitable donations.*See generally* 26 U.S.C. § 170(h).

Ms. Zak testified that when a conservation easement opportunity was available, she would notify Mr. Lloyd. (Zak 220:4-12.) Mr. Lloyd testified that, as a CPA and tax adviser, he explained the process of conservation easements to clients who might benefit from such a tax vehicle. (Lloyd 832:15-833:3; 833:15-834:8;762:9-763:21.) Mr. Lloyd described the total amount that must be contributed by each participant, his fee for performing the service, and the net tax benefit for each client. (Powell 618:10-15; Lloyd 755:25-758:6; 767:14-22; 832:22-835:9; Losby939:1-13; Brown 964:18-965:12; Hooks 1060:1-16;1063:13-1064:3; 1066:8-1067:2, 1073:17-1074:9; Branch 1088:10-1090:7; Price 1107:1-1108:11; 1116:19-1117:14; Goss 1129:11-1132:14; 1156:17-1157:6; 1163:20-1165:4; Hall 1171:1-1173:23.) The factual issues surrounding the fee are discussed *nfra*.

II. FC 2012 TRANSACTION

In 2012, Ms. Zak made Mr. Lloyd aware of Piney Cumberland Holdings, LLC ("PCH"), a conservation easement opportunity. (Zak 154:9-22; 238:10-15.) An Offering Summary prepared for PCH, dated October 15, 2012, offered common units of membership interest in PCH at a price of $2,384 per unit. (DOE Ex. 56B.) The minimum subscription per participant was 20 common units, requiring a minimum investment of $47,680. *Id.* PCH would itself acquire ownership units in Piney Cumberland Resources, LLC, ("PCR") which owned the underlying land. *Id.* PCR's sole purpose was the donation of a conservation easement. *Id.* The donation of the

conservation easement would then provide the members of PCH with a flow-through tax benefit. (DOE Ex. 56; Zak 156:17-157:4.)[2]

As an accountant and tax planner, Mr. Lloyd created Forest Conservation 2012, LLC, a Wyoming limited liability company ("FC 2012"). (Lloyd 761:20-762:4.) Mr. Lloyd's testimony shows that the purpose of FC 2012 was to group the contributions of his clients in one entity which would then purchase ownership interests in PCR through PCH. (Lloyd 766:10-15.) Mr. Lloyd grouped his clients' contributions in order to tailor the contribution and membership interests to the tax needs of each client (which might be greater than or less than the unit amount) and to allow each client to take a deduction for the cost of his fee. (Lloyd 845:20-846:5.) The tax planning fee paid to Mr. Lloyd counted as an ordinary expense for the LLC. (Lloyd 776:1-15.)

FC 2012 amassed $649,302.00 from a total of 18 members, including Mr. Lloyd who contributed $16,802.00, of which $105,750.00 was paid as a tax planning fee to Mr. Lloyd. (Lloyd 876:16-878:12.) Mr. Lloyd wired the $543,552.00 balance from the FC 2012 bank account to PCH on December 7, 2012, and FC 2012 purchased 228 units in PCH. (Lloyd 857:5-857:12, DOE Ex. 123.) PCH, in turn, purchased membership interests in the real estate entity PCR, and PCR donated a conservation easement to a qualifying land trust. FC 2012 received a Schedule K-1 for its portion of the contribution easement deduction, and Mr. Lloyd (on behalf of FC 2012) issued individual K-1's to all 18 participants indicating their respective percentages of the deduction. (*See* Resp.'s Ex. 24; Resp.'s Ex. 25; Lloyd 887:10-888:6.) Every participant received tax benefits substantially greater than their cash contribution. (*See* Resp.'s Ex. 25.)

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[2] Although SFA chose to treat PCH as a Regulation D (506) offering it was not a security and no such treatment was required nor did the offering need to be restricted to accredited investors. *See* Admin. Proc. Rulings Release No. 2366.

A. FACTS PRESENTED REGARDING THE FC 2012 OPERATING AGREEMENTS

The Operating Agreement ("OA") for FC 2012 was prepared by Mr. Lloyd. (*See* Resp.'s Ex.15.) The initial draft was prepared in March 2012, before any client contributed, and listed Mr. Lloyd as the sole member. *Id.* The OA defined a "member" to be "each person designated as a member of the Company on Schedule I hereto or any other persons admitted as a member of the Company in accordance with this agreement or the Act." The OA was first revised in December 2012, and Schedule I then listed the members of the LLC and their respective ownership percentages. (Resp.'s Ex. 16.)

Three of the participants in the FC 2012 transaction with PCH were erroneously not listed on the December 2012 Schedule I: Chris Brown ("Brown"), James Carson ("Carson"), and Mike Malloy ("Malloy"). (*See* Lloyd 880:24-881:23; Resp.'s Ex. 16.) All of these participants, however, had made contributions to FC 2012 and were admitted as members by the organizer, Mr. Lloyd. (*See* Resp.'s Ex. 40; Lloyd 132:15-17.) Pursuant to Wyoming LLC law, no writing was required to do this. *Id.* In the spring of 2013, all 18 members, including the three omitted from the December 2012 Schedule I, received K-1's correctly reflecting their original contribution and showing the expected tax benefit. (Resp.'s Ex. 24, Resp.'s Ex. 25.)

In the summer of 2014, all 18 members of FC 2012 signed an amendment to the OA, confirming that the December 7, 2012 version of Schedule I attached to the OA had a scrivener's error; stating the correct membership contributions, fees paid, and ownership percentages, (matching the K-1s); and ratifying all actions of Ed Lloyd. (Resp.'s Ex.16; Powell 626:22-627:18.)

Of the 18 clients who participated in FC 2012, only four were investment advisory clients: Vernon (Ray) Branch, Timothy Goss, Leslie (Lee) Powell and Larry Price. (Lloyd 710:19-711:2.) Their participation was as follows:

Name	Total	Contribution	Fee	Percent	Date	Bates	Exhibit
Branch	$40,000.00	$33,500.00	$6,500.00	6.163164%	11/12/12	ELA_002224	R17
Goss	$35,000.00	$29,000.00	$6,000.00	5.335276%	11/19/12	ELA_002227	R17
Powell	$60,000.00	$51,500.00	$8,500.00	9.474714%	9/25/12	ELA_002234	R17
Price	$40,000.00	$33,500.00	$6,500.00	6.163164%	11/12/12	ELA_002234A	R17

B. FACTS REGARDING MR. LLOYD'S FEE

A substantial portion of the Division's ever-changing case of alleged violations of Sections 206(1), (2), and (4) of the Advisers Act is that Mr. Lloyd misappropriated funds, either by "misappropriating" the funds of three tax planning clients Brown, Carson, and Malloy, or by "misappropriating" the funds of all of the participants in the FC 2012 transaction. (OIP ¶ 47.) The evidence shows that the difference between the total amount paid by participants into FC 2012 ($649,302.00) and the amount transferred to PCH ($543,552.00) was the aggregate of the tax service fees agreed to by the participants ($105,750.00) for Mr. Lloyd's tax work. Every client who testified or provided an affidavit stated that he or she had knowledge that there was a fee involved for Mr. Lloyd's tax planning services related to FC 2012. (Powell 618:10-15; Lloyd 755:25-758:6; 767:14-22; 832:22-835:9; Losby 939:1-13; Brown 964:18-965:12; Hooks 1060:1-16; 1063:13-1064:3; 1066:8-1067:2, 1073:17-1074:9; Branch 1088:10-1090:7; Price 1107:1-1108:11; 1116:19-1117:14; Goss 1129:11-1132:14; 1156:17-1157:6; 1163:20-1165:4; Hall 1171:1-1173:23.) There was no evidence to the contrary. The fees were disclosed in the amended and corrected OA, which ratified Mr. Lloyd's actions and were signed by every participant. (*See* Resp.'s Ex. 16.) The Division presented no evidence supporting the contentions that Mr. Lloyd stole money from any

of his clients under any of the theories described above.[3] The Division's proof entirely failed.

C. FACTS REGARDING MR. LLOYD'S STATEMENTS TO MS. ZAK

The evidence at the Hearing shows that the Division's assertion that ". . . Respondent willfully violated Section 206(1), 206(2) and 206(4) of the Advisers Act . . . which prohibit fraudulent conduct by investment advisers with regard to any client or prospective client . . ." is false. (OIP ¶58.) Ms. Zak testified that Mr. Lloyd informed her via email that tax planning client Carson was no longer participating in FC 2012. (Zak 179:1-11.) Mr. Lloyd testified that he made a statement to Ms. Zak regarding the involvement of Carson in the FC 2012 transaction. (Lloyd 805:24-806:23; DOE Ex. 84.) Although Respondent's testimony reflects that he made a misrepresentation to Ms. Zak and SFA, neither SFA nor Ms. Zak is a client or prospective client of Mr. Lloyd. The Division presented no evidence that supports its contention that Mr. Lloyd made any misrepresentations or false statements to any client or prospective client. (OIP ¶ 58.)

ARGUMENT

The Division alleges violations of Sections 206(1), (2) and (4) of the Investment Advisers Act as related to FC 2012. As shown below, Mr. Lloyd was not acting as an investment adviser as defined in Section 202(a)(11), and none of the allegations remaining from the OIP (and none of the Division's continually changing theories of liability) have been proven. Furthermore, the evidence shows that Respondent did not engage in any misconduct directed toward a client or prospective client.

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[3]Because it is clear that the Division knew, even before obtaining the OIP, that no witnesses would support its theory of "misappropriation," the conduct of the Division, were it a private party, would be sanctionable under F.R.C.P. 11 (and probably other theories the Divisions' proof entirely failed).

I. JURISDICTION/STATUS AS AN ACCOUNTANT

The Commission lacks jurisdiction over this matter because the transactions at issue did not involve the purchase or sale of a security as defined in § 2(a)(1) of the Securities Act and because Respondent did not act as an investment adviser with respect to any transaction at issue. 15 U.S.C. § 77b or § 80b-2(a)(18) of the Investment Advisers Act. Judge Foelak's February 27, 2015 order found that the transactions involved in this matter did not meet the *Howey* test for securities. *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

The enforcement provisions cited in the OIP, § 203(f) and § 203(k), also fail to provide enforcement jurisdiction of the Commission over this matter. 15 U.S.C. § 80b-3(f); 15 U.S.C. § 80b-3(k). Section 203(f) requires a finding of a violation subsection (e). The only applicable portions of that subsection are those related to violations of the Securities Act or Securities Exchange Act which now have been dismissed. Additionally, when 203(f) is read in conjunction with 203(e), it is clear that the enforcement provisions contained within the Advisers Act governs investment advisers. 15 U.S.C. §80b-3(e).Mr. Lloyd was acting as an accountant, and such conduct is not within the enforcement jurisdiction of the Commission.

Section 203(k) allows for entry of a cease and desist order if the Commission "finds . . . that any person is violating, has violated, or is about to violate any provision of this subchapter, or any rule or regulation thereunder. . . ." 15 U.S.C. §80b-3(k)(1). Section 203(k) states that the violation must be "due to an act or omission the person knew or should have known would cause such violation." The Respondent has not violated any provision of the Advisers Act as there was no act or omission which caused a violation.

Respondent maintains that no security was involved in the FC 2012 transaction, that Mr. Lloyd was acting as an accountant, not an investment adviser, at the time of the transaction, and that no false or misleading statement was made to any client or prospective client by Mr. Lloyd. Therefore, the SEC has no enforcement jurisdiction over this matter.

II. No Authority of ALJ

The ALJ had no authority to conduct a hearing because he is not an officer designated by the Commission. The statutory provisions of the Investment Advisers Act of 1940 state: "Hearings may be public and may be held before the Commission, any member or members thereof, or any officer or officers of the Commission designated by it, and appropriate records thereof shall be kept." 15 U.S.C. § 80b-12. On its face, this statutory language provides that only someone who is an officer of the Commission may be designated to hold these hearings.

Furthermore, because the Hearing may only be held by the Commission itself or an officer designated by it, this suggests that any hearing officer must be an officer who is empowered to exercise significant authority pursuant to the laws of the United States. *See Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.,* 561 U.S. 477, 486, 130 S. Ct. 3138, 3148, 177 L. Ed. 2d 706 (2010) (citing *Buckley v. Valeo*, 424 U.S. 1, 125-26, 96 S.Ct. 612, 46 L.Ed.2d 659 (1976) (*per curiam*) (quoting Art. II, § 2, cl. 2)).

This Hearing did not comply with the statutory requirement that such a Hearing should be heard before "an officer of the Commission." The Division and the Commission itself have admitted that ALJs are not officers, but are in fact, employees of the Commission. *See* Mem. of Law in Opp'n to PL's Mot. for TRO and a Prelim. Inj. at 11-19, *Duke v. SEC*, No. 15-357 (S.D.N.Y. Jan 28, 2015), ECF No. 13 (". . . SEC ALJs

are not constitutional officers. SEC ALJs are employees and thus their removal does not implicate Article II."); Div of Enforcement's Mem.of Law in Respon. To the Commission's Order Req. Supp. Briefing at 4-13, *In re Timbervest, LLC*, File No. 3-15519 (Feb. 12, 2015) ("SEC ALJs, however, are employees not constitutional officers, and thus the President's alleged lack of power to remove them does not implicate Article II.")

The Respondent is unaware of any ALJ who is an officer properly appointed to conduct hearings. Respondent contends that this hearing is void because ALJ Elliot is not an appropriately appointed officer, but only an employee of the Commission. An improperly constituted hearing is void and cannot be ratified. *Ryder v. United States*, 515 U.S. 177, 182-83, 115 S. Ct. 2031, 2035, 132 L. Ed. 2d 136 (1995).

III. DUE PROCESS

Respondent has been denied due process of law from the inception of these proceedings. Although this action has the potential to inflict serious financial and professional consequences, it is labeled a "civil proceeding" taking place in an administrative setting, without the benefit of a neutral and disinterested fact finder, the Federal Rules of Evidence, discovery, or other safeguards.

Because ALJs are employees of the Commission, there are significant issues of due process, including the basic tenets of a fair trial and the likelihood of bias, which was evident in the Hearing. Due process not only requires actual fairness but also the appearance of fairness. *See In re Murchison*, 349 U.S. 133, 136, 75 S. Ct. 623, 625, 99 L. Ed. 942 (1955) ("A fair trial in a fair tribunal is a basic requirement of due process. Fairness of course requires an absence of actual bias in the trial of cases. . . . '[J]ustice must satisfy the appearance of justice'"); *see also Amos Treat & Co. Inc. v. SEC*, 306

F.2d 260, 267 (D.C. Cir. 1962) ("[A]n administrative hearing of such importance and vast potential consequences must be attended, not only with every element of fairness but with the very appearance of complete fairness").

Although case law states that administrative proceedings are not a per se violation of due process, that does not exclude them from scrutiny. *See Kinsella v. Bd. of Ed. of Cent. Sch. Dist. No. 7 of Towns of Amherst & Tonawanda, Erie Cnty.*, 378 F. Supp. 54, 60 (W.D.N.Y. 1974) (citing *Richardson v. Perales*, 402 U.S. 389, 410, 91 S.Ct. 1420, 28 L.Ed.2d 842 (1971); *Marcello v. Bonds*, 349 U.S. 302, 75 S.Ct. 757, 99 L.Ed. 1107 (1965)). The due process clause itself does not require "proof of actual bias" but instead relies on a "realistic appraisal of psychological tendencies and human weakness." *See Caperton v. A.T. Massey Coal Co.,* 556 U.S. 868, 883, 129 S. Ct. 2252, 2263, 173 L. Ed. 2d 1208 (2009).

The simple fact that the Commission chooses the judge in its own case from amongst its employees calls the fairness of the process into question. *Id.* at 870. ("Just as no man is allowed to be a judge in his own cause, similar fears of bias can arise when . . . a man chooses the judge in his own cause.") This statement is particularly relevant, as ALJ Foelak, who had provided the Respondent with a favorable order immediately prior to the hearing (an unfavorable ruling for the Division), was summarily removed from the case on the eve of trial without explanation, replacing her with ALJ Elliot, calling into question the basic fairness of this proceeding.

Further evidence of the bias of ALJs, as Commission employees, is the SEC's recent record of winning, which has readily been acknowledged by the former chair of the SEC, Mary Jo White. The Respondent requested that ALJ Elliot take judicial notice

of facts surrounding the SEC's winning record in support of this brief. The SEC's own records show that the ALJs generally, and this ALJ specifically, have rarely, if ever, found in favor of the Respondent in the past two years.

It is axiomatic that "[t]he right to present evidence is, of course, essential to the fair hearing required by the Due Process Clause." *Jenkins v. McKeithen*, 395 U.S. 411, 424 (1969). At the Hearing, the ALJ consistently favored the position of the Division and the Commission. Throughout the hearing, Respondent's counsel made various objections to the admission of evidence on the basis that it simply was not relevant to the inquiry or was prejudicial to the inquiry. (Zak 99:15-25; 100:24-101:4; 101:57-102:9; 107:1-17:13; 109:1-10; 119:9-14; 126:11-127:7; 132:6-15; 133:20-139:23; 188:18-189:9; 197:14-24; 261:2-17; Dethfelsen 299:25-304:8, 311:15-312:5; 312:8-314:2; 317:7-14; 318:25-319:5; 330:5-331:2; Seiden 351:8-351:14; Hardin 443:21-445:12; 460:10-15; 463:1-10; 466:3-9; 469:9-18; 472:11-17; 486:23-487:12; 494:2-494:8; 523:17-525:4; Sywak 529:13-25; 531:7-14; Adams 583:1-24; 584:1-7; 611:20-24; Powell 631: 21-25; 637:5-638:4; 650:13-22; 655:21-25; 656:7-12; 660:17-25; Powell 662:4-11; 662:18-24; 665:6-13; 665:25-666:8; 666:23-667:4; 668:1-22; 670:1-16; Lloyd 713:3-16; 719:6-9; 735:15-736:3; 738:16-22; 760:18-22; 771:4-8; 912:19-25; 913:6-12; 914:13-18; 919:10-19; 922:2-10; Losby 939:14-20; 940:10-16; Brown 971:25-975:11; 983:12-22; 985:9-986:3; 986:15-20; 988:13-17; 989:19-22; 991:16-23; Lloyd 997:22-998:5; 1010:24-1011:3; 1011:23-1012:3; 1013:8-16; 1016:23-1017:5; 1021:22-1022:6; 1032:8-14; Hooks 1065:12-16; 1069:16-20; 1070:13-24; 1075:1-8; 1076:7-14; Branch 1099:1-8; Price 1115:6-10; 1149:5-11.) These objections ranged from testifying by the Division to the use of the word "security" throughout the proceeding, even though ALJ

Foelak had come to the conclusion in a prior order that a security was not at issue. (*See* Admin. Proc. Rulings Release No. 2366.) Furthermore, statements made by ALJ Elliot, on the record, regarding the Respondent are clear evidence of the bias of this tribunal. (Lloyd 697:1-14; 713:9-15; 723:14-724:13; 815:15-823:23.) Respondent was denied a neutral or disinterested fact finder.

IV. THE DIVISION HAS NOT ESTABLISHED THAT RESPONDENT WAS ACTING AS AN INVESTMENT ADVISER DURING THE FC 2012 TRANSACTION.

In order to establish a violation of the Advisers Act, a plaintiff must prove that defendants "(1) were investment advisors; (2) engaged in fraudulent activities; and (3) negligently breached their fiduciary duty by making false and misleading statements or omissions of material fact. *William L. Thorp Revocable Trust v. Ameritas Inv. Corp.*, No. 4:11-CV-193-D, 2014 WL 4923597, at *16 (E.D.N.C. Sept. 30, 2014) (citing *SEC v. Gotchey,* 981 F.2d 1251, 1992 WL 385284, at *2 (4th Cir.1992) (per curiam) (unpublished table decision) (citing *SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 192–95, 84 S.Ct. 275, 11 L.Ed.2d 237 (1963)).

The Division cannot establish that Mr. Lloyd meets the first prong of this test. The definition of "Investment Adviser" in section 15 U.S.C. § 80b-2(a)(11) of the Advisers Act states: "'Investment adviser' means 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**, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning **securities**" (emphasis added). No securities were involved in the transaction at issue.

The SEC itself has stated that "whether a person providing financially related service . . . is an investment adviser . . . depends upon all of the relevant facts and circumstances." Additionally, a person must satisfy all three elements to fall within the definition of "investment adviser." *Applicability of the Investment Advisers Act of 1940 to Financial Planners, Pension Consultants, and Other Persons Who Provide Others with Investment Advice as a Component of Other Financial Services*, Investment Advisers Act Release No. 1092 (Oct. 8, 1987) ("Release 1092").

Mr. Lloyd does not fall within the meaning of "investment adviser" in 202(a)(11) as interpreted by the SEC itself. The FC 2012 transaction has been deemed not to be a security, per Judge Foelak's order. Mr. Lloyd, during the FC 2012 transaction, did not provide any advice to others or issue any reports regarding a security, nor was he engaged in the business of doing so at the time of the FC 2012 transaction. (Lloyd 829:19-831:18; Brown 964:14-17.)

Furthermore, during the course of the Hearing, Mr. Lloyd presented evidence that he was acting as a CPA and was wearing his tax advising "hat" during the FC 2012 transaction. (Lloyd 717:12-18; 726:9-20.) An integral part of a CPA's job is to offer tax advice to his clients. (Lloyd 835:20-16.) The definition of "Investment Adviser" specifically excludes: "(B) any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession." 15 U.S.C. § 80b-2(a)(11)(B). As FC 2012 was a tax vehicle, and Mr. Lloyd was using his expertise as a tax planner during the transaction, he ought not be subject to the Investment Advisers Act of 1940, as he falls squarely within the exclusion provided by 15 U.S.C. § 80b-2(a)(11)(B).

Although Respondent held an investment adviser's license and serves investment advisory clients, his services regarding the FC 2012 transaction were within the scope of his profession as a CPA, providing tax advice and assisting his clients in reducing tax liability through a perfectly legal deduction. 26 U.S.C. §170; *see Irby v. C.I.R.,* 139 T.C. 371, 380 (2012).

At hearing, the Division provided no evidence to refute testimony that Mr. Lloyd was acting as a CPA. (Powell 614:7-615:23; Losby 928:22-930:9; Brown 961:25-962:22; Hooks 1057:1-21; Branch 1084:19-1088:20; Price 1107:1-14; Goss 1128:1-1129:1; Hall 1169:14-1170:16.)

V. THERE WAS NO SUBSTANTIVE VIOLATION OF§206(1).

A. NO EVIDENCE WAS PRESENTED THAT ANY OF MR. LLOYD'S TAX CLIENTS RECEIVED ANYTHING BUT WHAT WAS EXPECTED.

The Division cannot establish a violation of §206(1) as there is simply no evidence of a device, scheme, or artifice to defraud a client or prospective client. 15 U.S.C. § 80b-6(1) (2014). Furthermore, the Division would have to prove that the fraud was done with scienter. *Steadman* at 1134.

The Division's allegation of fraud in the violation of Section 206(1) is based in part on the theory that three participants (Carson, Brown, and Malloy, none of whom were Investment Advisory clients) involved in the FC 2012 Transaction, were not listed on Schedule I in December 2012 due to a scrivener's error. The Division makes the leap that due to this clerical error, Carson, Brown, and Malloy did not receive what they paid for: a membership interest and a tax deduction. (OIP ¶¶ 46-51.) The Division is wrong on the facts and wrong on the law.

As described in the facts section *supra*, the OA for FC 2012 defines a "member" as "each person designated as a member of the Company of Schedule I hereto or any other persons admitted as a member of the Company in accordance with this agreement *or the Act*" (emphasis added). The Wyoming Limited Liability Company Act states that "(b) if a limited liability company is to have more than one (1) member . . . those persons become members as agreed by them. The organizer acts on behalf of the persons in forming the company . . . ." Wyo. Stat. Ann. § 17-29-401(2010). As described by Respondent's expert, *author* of the Wyoming LLC Act, the operating agreement for the LLC may be oral or implied. Wyo. Stat. Ann. § 17-9-012(xiv) (2010). It is not required to be written. (Resp.'s Ex. 40.)

Mr. Lloyd was authorized to act on behalf of all members of the LLC as its organizer and original member. He further had the authority to admit the other seventeen participants as members by stating that he was admitting them as members of the LLC in an empty room. For the purposes of Wyoming, LLC law, this would be sufficient to admit the additional members. (Resp.'s Ex. 40.) Carson, Malloy, and Brown were, in fact, members of the LLC.

The Division's alternate, and disparate, theory is that the members other than Carson, Malloy and Brown were cheated out of what they were promised. The Division's theory is that the percentage they were promised was diminished by the percentage interests provided to Carson, Malloy, and Brown. There was no diminishment of percentage interest provided to any of the members, and each client received exactly what they paid for.

Multiple witnesses, including Jennifer Brown, testified that they had participated in FC 2012, donated a conservation easement via PCH, and in return received a tax credit. (Lloyd 1051:24-1052:2.) Each client testified or provided affidavits that they had, in fact, received exactly what they bargained for, and were happy with what they received. (Resp.'s Ex. 39; Powell 625:7-9; Losby 931:20-932:5; Hooks 1060:21-25; Price 1107:21-24; Goss 1135:15-17; Hall 1174:12-14.) Carson, Brown, and Malloy provided affidavits declaring that they were told what they would receive, and they in fact received it. (*See* Resp.'s Ex. 39) Furthermore, the K-1's reiterate that each participant received exactly what they were promised. (Resp.'s Ex. 24, 25.)

The purpose of anti-fraud securities law is to restore defrauded individuals the "benefit of the bargain." *See AUSA Life Ins. Co. v. Ernst & Young,* 39 Fed.Appx.667, 671 (2d Cir. 2002). Every FC 2012 participant has received the benefit of the bargain, and no device, scheme, or artifice was employed. *US.v.Starr,* 816 F.2d 94, 98 (2d Cir. 1987) ("[In a fraud case,] the harm contemplated must affect the very nature of the bargain itself. Such harm is apparent where there exists a discrepancy between benefits reasonably anticipated . . . and actual benefits . . . delivered.")

B. THERE IS NO EVIDENCE THAT ANY MISREPRESENTATIONS WERE MADE TO CLIENTS OR PROSPECTIVE CLIENTS.

The Division further relies on the theory that material misstatements of fact were made to clients or prospective clients. No evidence supports that any false statement was made by Mr. Lloyd to any client or prospective client. Testimony, as well as the affidavits, show that all participants were aware of Mr. Lloyd's fee for his tax work. (Powell 618:10-15; Lloyd 755:25-758:6; 767:14-22; 832:22-835:9; Losby 939:1-13; Brown 964:18-965:12; Hooks 1060:1-16; 1063:13-1064:3; 1066:8-1067:2, 1073:17-

1074:9; Branch 1088:10-1090:7; Price 1107:1-1108:11; 1116:19-1117:14; Goss 1129:11-1132:14; 1156:17-1157:6; 1163:20-1165:4; Hall 1171:1-1173:23.)

Although not alleged in the OIP, the Division now asserts a theory that the December 2012 statements to Ms. Zak at SFA support that a fraud was perpetrated on a client. Again, Ms. Zak and SFA were not clients, nor prospective clients for the purpose of the Investment Advisers Act, and any misrepresentation to Ms. Zak was collateral to the transaction. *U.S. v. Regent Office Supply Co.,* 421 F.2d 1174, 1182 (2d Cir. 1970) (finding no scheme to defraud where the misrepresentation was collateral to the sale and did not concern the quality or nature of the goods being sold and there was no discrepancy between benefits reasonably anticipated and actual benefits received). Although *U.S. v. Regent Office Supply* concerns itself with mail fraud as opposed to securities law, it is instructive in the understanding of "scheme to defraud."

C. THE DIVISION PROVIDED NO EVIDENCE OF SCIENTER NEEDED FOR A VIOLATION OF §206(1).

In order to prove a violation of §206(1), the Division must prove scienter. *Steadman v. SEC*, 603 F.2d 1126, 1134 (5th Cir. 1979) *aff'd sub nom. Steadman v. SEC*, 450 U.S. 91, 101 S. Ct. 999, 67 L. Ed. 2d 69 (1981).

No facts presented at the Hearing point to a misrepresentation made by Mr. Lloyd, much less any knowingly false statements to any of his clients or prospective clients. Without evidence supporting a purposeful scheme to defraud clients and no evidence of a violation of § 206(1) for the 2012 transaction, Mr. Lloyd simply cannot be found in violation of §206(1).

VI. THE DIVISION HAS NOT PROVIDED ANY EVIDENCE TO SUPPORT A SUBSTANTIVE VIOLATION OF §206(2) OF THE INVESTMENT ADVISERS ACT OF 1940.

As noted *supra*, § 206((2) of the Advisers Act provides that it is unlawful ". . . for any investment adviser . . . (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client . . . ." 15 U.S.C. § 80b-6(2) (2014). Scienter is not required in for a violation of Section 206(2). *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195, 84 S.Ct. 275, 284 (1963). "All that need be shown is that (1) the Defendant is an investment adviser; (2) the Defendant used the mails or any other means or instrumentality of interstate commerce, directly or indirectly; (3) to make a misstatement or omission of material fact to a client or prospective client; and (4) the Defendant acted negligently." *Morris v. Wachovia Sec., Inc.,* 277 F. Supp. 2d 622, 644 (E.D. Va. 2003).

A. RESPONDENT WAS NOT ACTING AS AN INVESTMENT ADVISER.

As previously argued, Respondent was not an investment adviser within the scope of 15 U.S.C. § 80b-2(a)(11) as he was acting as a CPA with tax advising clients during the FC 2012 transaction. Accountants and other professionals are exceptions to the definition of an investment adviser pursuant to 15 U.S.C. § 80b-2(a)(11)(B). Testimony at the Hearing show that both Mr. Lloyd, and Mr. Lloyd's clients, regarded him as a CPA rather than as an investment adviser during this transaction. (Powell 614:7-615:23; Losby 928:22-930:9; Brown 961:25-962:22; Hooks 1057:1-21; Branch 1084:19-1088:20; Price 1107:1-14; Goss 1128:1-1129:1; Hall 1169:14-1170:16.) The Division cannot meet the first prong of the *Morris* test.

B. THE EVIDENCE AT THE HEARING DOES NOT SHOW THAT RESPONDENT ENGAGED IN ANY TRANSACTION, PRACTICE, OR COURSE OF BUSINESS WHICH OPERATED AS A FRAUD OR DECEIT UPON A CLIENT OR MADE A MATERIAL MISSTATEMENT TO A CLIENT OR PROSPECTIVE CLIENT.

For the same reason that the Division cannot prove any of the alleged violations of §206(1), the Division cannot prove any of the alleged violations of §206(2) for the FC 2012 transaction because each and every client received exactly what they bargained for: a tax benefit provided to them in return for a purchase of membership interest in FC 2012. (*See* Resp.'s Ex. 39; Powell 625:7-9; Losby 931:20-932:5; Hooks 1060:21-25; Price 1107:21-24; Goss 1135:15-17; Hall 1174:12-14.) Each client knew exactly what he or she was bargaining for, and there was no fraud, deceit, or manipulation on the part of Mr. Lloyd directed toward a client.

Section 206(2) of the Adviser's Act, like Section 206(1), requires that the conduct at issue, the fraud or deceit, have a direct impact on a client or prospective client. No evidence at the Hearing supports that any false statements or omissions of material fact were made by Mr. Lloyd to any client or prospective client. The Division has no evidence demonstrating that Mr. Lloyd meets the third prong of the *Morris* test.

Testimony at the Hearing, as well as the affidavits of clients, showed that all clients were aware of Mr. Lloyd's fee for his tax work. (Powell 618:10-15; Lloyd 755:25-758:6; 767:14-22; 832:22-835:9; Losby 939:1-13; Brown 964:18-965:12; Hooks 1060:1-16; 1063:13-1064:3; 1066:8-1067:2, 1073:17-1074:9; Branch 1088:10-1090:7; Price 1107:1-1108:11; 1116:19-1117:14; Goss 1129:11-1132:14; 1156:17-1157:6; 1163:20-1165:4; Hall 1171:1-1173:23.) Again, the Division relies on the December 2012 statements to Ms. Zak at SFA to support the theory that a fraud had been perpetrated on a client. Ms. Zak and SFA are simply not clients or prospective clients for the

purpose of the Advisers Act, and any misrepresentation to Ms. Zak was not central, but merely collateral, to the transaction. *U.S. v. Regent Office Supply Co.,* 421 F.2d 1174, 1182 (2d Cir. 1970).

VII. THE DIVISION FAILED TO PROVE THAT THERE WAS A SUBSTANTIVE VIOLATION OF SECTION 206(4) OF THE INVESTMENT ADVISERS ACT OF 1940.

There is insufficient evidence of an investment adviser engaging in "any act, practice, or course of business which is fraudulent, deceptive, or manipulative" to support a substantive violation of §206(4) of the Advisers Act.

A. THE DIVISION HAS NOT ESTABLISHED THAT MR. LLOYD WAS ACTING AS AN INVESTMENT ADVISER UNDER THE ACT.

The plain language of the statute, once again, requires that an investment adviser engage in particular acts in order to be in violation of §206(4). It is the Respondent's position that as to §206(4), that Mr. Lloyd was not acting as an investment adviser as defined by the Act, but instead he was acting in his capacity as a CPA, providing tax planning advice. There was no security involved in this transaction.

B. THE INTENT OF THE LEGISLATURE WITH REGARD TO THE INVESTMENT ADVISERS ACT, INCLUDING §206(4), FORECLOSES ITS APPLICABILITY TO THE RESPONDENT.

The legislative intent of the Adviser Act was clearly focused on the preservation of the "the personalized character of the services of investment advisers" and the elimination of "conflicts of interest between the investment adviser and the clients" in order to provide "safeguards both to 'unsophisticated investors' and to 'bona fide investment counsel'." *Sec. & Exch. Comm'n v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 191-92, 84 S. Ct. 275, 282-83, 11 L. Ed. 2d 237 (1963). There is no evidence that any one of these clients was an investor with respect to the FC 2012

transaction or that Mr. Lloyd was acting as investment counsel. The clients were merely seeking a tax benefit, and Mr. Lloyd was a CPA who provided them with that benefit.

C. NO FRAUDULENT, DECEPTIVE, OR MANIPULATIVE STATEMENTS MADE TO ANY CLIENT OR PROSPECTIVE CLIENT.

As noted *supra*, the purpose of the Act was for the protection of clients. Any material misstatement made during the course of the FC 2012 transaction was in no way directed toward a client. Testimony clearly shows that clients who were involved in FC 2012 were aware of Respondent's tax assistance fees. (Powell 618:10-15; Lloyd 755:25-758:6; 767:14-22; 832:22-835:9; Losby 939:1-13; Brown 964:18-965:12; Hooks 1060:1-16; 1063:13-1064:3; 1066:8-1067:2, 1073:17-1074:9; Branch 1088:10-1090:7; Price 1107:1-1108:11; 1116:19-1117:14; Goss 1129:11-1132:14; 1156:17-1157:6; 1163:20-1165:4; Hall 1171:1-1173:23.) Furthermore, there is no possibility of fraud of a client because none of the statements the Division asserts violated Section 206(4) were directed toward clients.

D. PENALTIES AND DISGORGEMENT

The potential consequences of an administrative hearing of this magnitude are substantial, and thus the issues of due process ought not to be taken lightly. The consequences could include substantial fines as well as professional consequences to Respondent's professional licenses. In the event that the ALJ finds Mr. Lloyd has violated any of Sections 206(1), 206(2) or 206(4), a fine may be imposed based on the schedule provided in Section 203 of the Advisers Act. "[T]he Commission is authorized by § 203 to impose various administrative sanctions on persons who violate the Act,

including § 206." *Transamerica Mortgage Advisors, Inc. (TAMA) v. Lewis*, 444 U.S. 11, 20, 100 S. Ct. 242, 247, 62 L. Ed. 2d 146 (1979).

Penalties under the Advisers Act are divided into three possible tiers, each with a higher penalty attached to it. In the first tier, the amount imposed for each violation "shall be $5,000 for a natural person or $50,000 for any other person." 15 U.S.C. §80b-3(i)(2)(A). The second tier imposes higher penalties per violation, but may only be invoked if the violation involved fraud, deceit, manipulation, or a deliberate or reckless disregard of a regulatory requirement. 15 U.S.C. §80b-3(i)(2)(B). The third tier imposes significantly higher penalties, but only applies if the violation satisfies all the requirements for the second tier and, in addition, the Court concludes that the violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons. 15 U.S.C. §80b-3(i)(2)(C). These fines range from $5,000 to $500,000.

In deciding what penalty should be assessed, the ALJ must look to Section 203(i) of the Investment Advisers Act , which provides that, in determining whether a penalty is in the public interest, the ALJ may consider (1) whether the violation involved fraud or deceit, (2) the resulting harm to other persons, (3) any unjust enrichment, (4) the respondent's prior regulatory record, (5) the need to deter the respondent and other persons, and (6) such other matters as justice may require. 15 U.S.C. § 80b-3(i).

No monetary penalty should be assessed, as only one of the public interest factors here is relevant: whether the violation involved fraud or deceit. No such fraud or deceit to any client or prospective client was proved during the course of the Hearing. The misstatement to Ms. Zak was merely collateral to the transaction and was not made to

any client or prospective client. No one, not one client, was hurt or unjustly enriched, and the Respondent in no way received any improper benefit. Each client received exactly what he or she bargained for and paid Respondent for his time in assisting them as a CPA. The Respondent's record is otherwise unblemished, and there is no need to deter an error which had no harmful effect.

Imposing a penalty for an accidental error, which had absolutely no detrimental or un-bargained for beneficial impact on any client, would be unconstitutional under the Excessive Fines Clause of the 8th Amendment as it is grossly disproportionate to the underlying conduct. *See* U.S. Const. amend. VIII. As a matter of public policy, as there has simply been no evidence of any violation of the Investment Advisers Act and no harm has occurred; punishing a minor error with a penalty of this magnitude would be grossly disproportionate and unconstitutional. Any penalty should, in any case, be limited to $5,000 for a single violation.

With regard to the disgorgement requested by the Division pursuant to 15 U.S.C. §8b-3(k)(5), there is simply nothing disgorge to any client, as each and every client received exactly the tax benefit they paid for and expected. If a violation is found any disgorgement should be limited to the fees charged to investment advisory clients Brown, Goss, Powell, and Price, $27,000.00. (*See* Resp.'s Ex. 17.)

CONCLUSION

For the reasons set forth above, the Respondent respectfully request an initial decision which reflects the analysis and conclusions above, as there has been no evidence at all of any fraud, scheme to defraud, or fraudulent or deceptive act or practice, much less of a knowing fraudulent or deceptive act.

Respectfully submitted, this the 1st day of May, 2015.

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CERTIFICATE OF SERVICE

I certify that the **RESPONDENT'S POST-HEARING** was served upon the parties to this action as follows:

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