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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Administrative Proceeding
File No. 3-16182

In the Matter of

PAUL EDWARD "ED" LLOYD, JR., CPA

Respondent.

DIVISION'S PETITION FOR CROSS REVIEW OF THE INITIAL DECISION

Dated: September 17, 2015

Robert F. Schroeder (ELH)
Attorney for Division of Enforcement
Brian M. Basinger
Attorneys for the Division of Enforcement
Securities and Exchange Commission
950 E. Paces Ferry Road NE
Suite 900
Atlanta, Georgia 30326-1232

Pursuant to Rule 410(b) of the Commission's Rules of Practice, the Division of Enforcement hereby cross-petitions the Commission for review of the summary disposition order of ALJ Foelak, dismissing the Division's claims under Section 17(a) of the Securities Act of 1933; Sections 10(b) and 15(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; and Rule 206(4)-8 of the Investment Advisers Act of 1940. *Paul Edward "Ed" Lloyd, Jr., CPA*, Admin. Proc. Rulings Release No. 2366 (Feb. 27, 2015). Upon reassignment of the matter, ALJ Elliot ruled that he would not reconsider the summary disposition order. The Division seeks review of this ruling. Finally, the Division seeks review of ALJ Elliot's dismissal of the Division's claims under Sections 206(1) and (2) of the Advisers Act. Initial Decision Release No. 840 (July 27, 2015).

A. **Background**

Respondent Paul Edward "Ed" Lloyd, Jr., is a North Carolina-licensed certified public accountant ("CPA") and tax-planner and preparer. Lloyd is the sole owner of his tax-planning business, Ed Lloyd & Associates, PLLC. Between October 2006 and March 2013, he also was a registered representative and associated person of LPL Financial, LLC ("LPL"), a broker-dealer and investment adviser registered with the Commission.

Between December 2011 and December 2012, Lloyd offered and sold interests to his tax and advisory clients in three limited liability companies and special purpose vehicles that Lloyd created and controlled. These entities were intended to pool investor funds and purchase interests in real-estate equity offerings involving land that could either be used for development, such as homes, or conserved through an easement and thereby generate tax credits. The decision as to whether the land would be developed or conserved could only be made by a vote of those holding membership units after each offering had closed. The entities that Lloyd created were:

Forest Conservation 2011, LLC, which was created to buy ownership units in an offering by Maple Equestrian, LLC ("Maple Equestrian"); Forest Conservation 2012, LLC , which was created to buy ownership units in an offering by Piney Cumberland Holdings, LLC (hereafter, "Piney Cumberland") and Forest Conservation 2012 II, LLC, which Lloyd created to buy ownership units in an offering by Meadow Creek Holdings, LLC ("Meadow Creek"). Piney Cumberland, Maple Equestrian and Meadow Creek all filed Form Ds (Notice of Exempt Offering of Securities) with the Commission in connection with their offerings.

Lloyd never told LPL of the Forest Conservation entities that he created, nor did Lloyd inform LPL that he was selling ownership interests in the entities to tax and advisory clients. Lloyd induced seventeen of his tax-planning clients, including four who also were Lloyd's LPL investment advisory clients, to purchase a total of $632,500 of interests in Forest Conservation 2012, telling his clients that the resulting tax credit would likely exceed their investment amount. However, Lloyd only used $502,500 of the clients' funds that he raised to purchase ownership units of Piney Cumberland for his clients, and used the remaining $130,000 for his personal expenses and to increase his own investment in this venture. In paperwork submitted to the broker dealer sponsoring the Piney Cumberland offering, Lloyd identified only fourteen of his clients (including the four who also were his advisory clients), along with himself, as investors and did not identify any participation by the three clients whose money he stole. Indeed, when a representative of the broker dealer specifically asked whether one of these three clients was participating in the Piney Cumberland offering based on draft paperwork she had seen, Lloyd responded that the client was "OUT." (Emphasis in original). The Forest Conservation 2012 operating agreement, which Lloyd provided to the broker dealer sponsoring the Piney Cumberland offering, also made no reference to these three clients.

After his actions were discovered by the Commission's staff, Lloyd attempted to conceal his misconduct, claiming that substantially all of the misappropriated funds were tax fees charged to his clients. To corroborate this story, Lloyd prepared and distributed to all seventeen of his clients individual Internal Revenue Service ("IRS") Schedule K-1s (IRS Form 1065 – Partner's Share of Income, Deductions, Credits, etc.) showing that they had each invested the amount they had given Lloyd, less his purported fee, which varied in amounts and percentages from client to client. Lloyd also had each client sign an amended operating agreement for Forest Conservation 2012 that showed all 17 investors as members.

Based on these facts, the OIP alleged that Lloyd violated Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, Section 17(a) of the Securities Act and Sections 206(1), (2) and (4) of the Advisers Act and Rule 204(4)-8 thereunder. For the antifraud claims, the OIP alleged that (1) Lloyd misappropriated investor funds, (2) issued false K-1s to the investors (including his advisory clients); and (3) made false statements to the broker dealer that sponsored the Piney Cumberland offering. Prior to the hearing, Judge Foelak granted partial summary disposition in favor of Lloyd, dismissing all claims under the Exchange Act and Securities Act, as well as the claims under Rule 206(4)-8 of the Advisers Act. Judge Foelak reasoned that the investments ultimately were for tax purposes, and thus not securities transactions.

The case was then reassigned to Judge Elliot, who promptly advised that he would not revisit the summary disposition ruling. In his initial decision, Judge Elliot rejected the claims under Advisers Act Sections 206(1) and (2), largely because, during the hearing, several clients testified that Lloyd was entitled to a fee and the K-1s showed that all 17 investors had an interest in Forest Conservation 2012. Judge Elliot did conclude that Lloyd made misrepresentations to

the broker-dealer sponsoring the investment by (i) telling the broker dealer that one of the three clients was not an investor and (ii) concealing from the broker dealer the participation of the other two investors. Because these misrepresentations to the broker dealer selling the real-estate offering for Piney Cumberland were not directed at a client or potential client, Judge Elliot only found that Lloyd violated Advisers Act Section 206(4), but not Sections 206(1) or (2).

B. **Discussion**

1. The Transactions in this Case Involved Securities

ALJ Foelak found that the elements of *SEC. v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946), were met with respect to the Maple Equestrian (Forest Conservation 2011), Piney Cumberland Holdings (Forest Conservation 2012) and Meadow Creek Holdings (Forest Conservation 2012, II) offerings, with the exception of the third element – that the investor "[was] led to expect profits" - reasoning that the purpose of those offerings was for investors "to obtain tax deductions," not profits. This ruling is wrong.

The offerings were specifically "offered and sold in reliance on the exemptions from the registration requirements provided by" the Securities Act of 1933. Forms D were filed with the Commission for Maple Equestrian, Piney Cumberland and Meadow Creek, noting that the offerings were real-estate equity offerings. Lloyd used similar language on the face page of his Operating Agreements for the Forest Conservation entities that he created for the pooling of investor funds. Moreover, these offerings were only available to accredited investors. Furthermore, even if the investors chose to pursue the conservation easement option rather than the development option, they would continue to retain a percentage ownership interest in the underlying real estate, which could be sold at a later date for a profit. In short, the transactions were a two-chapter book: In the first chapter, Lloyd's Forest Conservation entities had to buy ownership units in real-estate offerings; only then, after each securities transaction was closed

and finalized could members, in chapter two, then decide whether to develop the land into houses or conserve the land for a tax credit. The Division's position is that the transactions were securities during both chapters.

First, in "chapter one," once the offering subscriptions closed, conservation easements had not yet been proposed, voted upon, granted or filed for Maple Equestrian Holdings, Piney Cumberland Holdings, or Meadow Creek Holdings. At that time, the Forest Conservation investors merely owned membership interests in private securities offerings by those entities.

As for "chapter two," case law regarding the relationship between tax benefits and the existence of an investment contract has developed over the last several decades. In United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 853-58 (1975), the Supreme Court held that residents of a government-financed co-op building who bought "shares" in the co-op in exchange for residential space did not purchase "securities" under the Howey test because the residents purchased the shares for "personal consumption or living quarters for personal use" and "were attracted solely by the prospect of acquiring a place to live, and not by financial returns on their investments." Further, the Court held that mortgage interest paid by the residents, while deductible for the residents' tax purposes, did not constitute a "security" because such "tax benefits are nothing more than that which is available to any homeowner who pays interest on his mortgage." Id. at 855.

In 1986, the Supreme Court, in Randall v. Loftsgaarden, 478 U.S. 647, 667 (1986), held that "tax benefits" from an investment in a tax shelter were not to be used in calculating "actual damages," *i.e.*, the court did not reduce the investor's recovery by the tax benefits actually received from a tax shelter investment which involved fraud in the offering terms. The Randall case was a dispute concerning whether tax benefits would reduce an investor's recovery under a

theory of rescission. However, Randall did not address the Howey analysis *in any way*. Case law before and after Randall has found that a "security" may exist in the form of tax benefits where promoters take sufficient steps to create the reasonable expectation of profits on the part of a purchaser. Newmyer v. Philatelic Leasing Ltd., 888 F.2d 385, 394 (6th Cir. 1989), cert. denied, 495 U.S. 930 (1990) (holding that tax benefits alone do not satisfy the "profit" element under Howey, but also finding a material question of fact existed as to whether a tax shelter involving leasehold interests of postage stamp printing plates was an investment contract under Howey, and observing in *dicta* that a trier of fact would likely examine the promoter's appraisals, offering memorandum and a "glowing" description of the popularity of stamp collecting in determining whether a reasonable expectation of profits existed); see also Investors Credit Corp. v. Extended Warranties, Inc., 1989 WL 67739 at * 28 (M.D. Tenn. 1989) ("As to profits, tax benefits which are the dominant inducement for investing are properly considered to be profits in satisfaction" of the Howey test). Lloyd sold the investments to his clients promising they would net more money in taxes saved than they would put into the Forest Conservation entities. Specifically, he wrote to one client: "A $35,000 contribution into the land trust reduces your taxes approximately $53,000."

Any earnings expected, whether residential-lot sale profits, easement tax deduction net profits, or future sales of land profits, would come from the efforts of others, as Lloyd's clients' only meaningful role was to write checks and wait for their *pro rata* profit. Once Lloyd's clients provided their investment funds to the Forest Conservation entities, to be invested in, as the case may be, Maple Equestrian Holdings, LLC, Piney Cumberland Holdings, LLC, or Meadow Creek Holdings, LLC, they had no role in the success or failure of the ventures. They were passive investors relying on the efforts of others to generate their profits. See SEC v. Merklinger, 489

Fed. Appx. 937, 940-941 (6th Cir. 2012) (holding that the SEC sufficiently alleged that investments in an LLC constituted "securities" under federal securities fraud law where the LLC principal represented the LLC as a passive investment for which investors could expect significant returns).

Because these investments were securities, Lloyd acted as an unregistered broker dealer, in violation of Section 15(a) of the Exchange Act, when selling the interests to his clients without the knowledge of approval of LPL (*i.e.*, Lloyd was selling away from LPL). Lloyd also violated Section 10(b) of the Exchange Act, Rule 10b-5 thereunder and Section 17(a) of the Securities Act by (1) concealing the existence of three investors from the broker dealer sponsoring the Piney Cumberland offering, (2) misappropriating three investors' funds and (3) issuing false K-1s to all investors that (a) reduced the investment amount of fourteen investors and (b) misrepresented that three investors had actually invested in Forest Conservation 2012 (when, in fact, Lloyd had stolen their money).

2. Lloyd Violated Sections 206(1) and 206(2) of the Advisers Act

Lloyd, an associated person with LPL Financial, was an investment adviser as defined by Section 202(a)(11) of the Advisers Act. Lloyd violated Sections 206(1) and 206(2) of the Advisers Act through a knowing fraud. He advised the Forest Conservation 2012 fund, his advisory client, by advising it not to invest the full amount of money it raised. He also defrauded fourteen investors in Forest Conservation 2012 by not basing their tax reductions on the full amounts they invested and acquired in Piney Cumberland Holdings ownership interests, including his four formal LPL advisory clients, as well as ten other prospective advisory clients. Finally, he defrauded three prospective advisory clients, whom he advised to invest in Forest Conservation 2012 and the Piney Cumberland Holdings offering, but whose money he misappropriated before he later provided them

with false K-1s based on ownership interests in Forest Conservation 2012 which they never acquired.

C. Conclusion

For the foregoing reasons, the Commission should grant the Division's Petition for Cross Review of the Initial Decision.

This 17th day of September 2015.

Respectfully submitted,

Robert F. Schroeder
Brian M. Basinger
Attorneys for the Division of Enforcement
Securities and Exchange Commission
950 E. Paces Ferry Road NE, Suite 900
Atlanta, Georgia 30326-1232
(404) 942-0688 (Schroeder)
(404) 842-5748 (Basinger)
schroederr@sec.gov
basingerb@sec.gov

CERTIFICATE OF SERVICE

The undersigned counsel for the Division of Enforcement hereby certifies that he has served the **DIVISION's PETITION FOR CROSS REVIEW OF THE INITIAL DECISION** by UPS overnight mail and electronic mail, to the individuals identified below:

Honorable Cameron Elliot
Administrative Law Judge
Securities and Exchange Commission
100 F Street NE
Room 2557
Washington, D.C. 20549-2557

Secretary Brent J. Fields (original and three copies)
Securities and Exchange Commission
100 F Street N.E.
Washington, DC 20549-1090

Frederick K. Sharpless, Esq.
Stavola & Sharpless, P.A.
200 South Elm Street, Suite 400
Greensboro, NC 27401

Alex Rue
AlexRueLaw LLC
4060 Peachtree Rd.
Suite D511
Atlanta, GA 30319

William Woodward Webb, Jr.
The Edmisten, Webb & Hawes Law Firm
127 West Hargett Street, Suite 104
Raleigh, North Carolina 27601

Dated: September 17, 2015

Robert F. Schroeder (ELH)
Attorney for Division of Enforcement