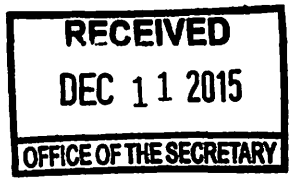
HARD COPY

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 OF ENFORCEMENT'S PRINCIPAL AND RESPONSE BRIEF

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

## TABLE OF CONTENTS

**TABLE OF AUTHORITES** ..... 4

**I. SUMMARY** ..... 8

**II. FACTS** ..... 10

A. Introduction ..... 10

B. The Forest Conservation 2012 Fraud ..... 12

i. The Piney Cumberland Offering ..... 12

ii. Respondent Leaves Out Brown, Carson and Malloy from FC 2012 ..... 14

iii. The Transaction Occurs and FC 2012 Acquires Piney Cumberland Membership Units ..... 15

C. Respondent's Cover Up ..... 17

i. Respondent Misleads the National Exam Program ..... 17

ii. Respondent Uses False Tax Documents to Mask His Scheme ..... 19

iii. Respondent Misleads Enforcement Staff and Clouds Clients' Memories ..... 20

**III. DISCUSSION** ..... 21

A. The Transactions Were Securities Under the Howey Test ..... 21

i. The Howey Test for Investment Contracts ..... 22

ii. Profits Were Possible from the Development or Sale of the Land ..... 23

iii. Profits Were Possible through Net Financial Gain Based on Tax Deductions Following the Land Preservation ..... 25

iv. Respondent's Clients Were Passive Investors ..... 27

B. Respondent Acted as an Unregistered Broker-Dealer ..... 28

C. Respondent Violated the Antifraud Provisions of the Securities Act and the Exchange Act ..... 30

i. Respondent Misappropriated Client Funds ..... 31

ii. Respondent Used False Tax Documents to Cover Up His Scheme ..... 33

D. Respondent Violated the Prohibited Transaction Provisions of the Advisors Act ..... 34

i. Respondent Was an Investment Advisor in the Relevant Transactions ..... 35

ii. Respondent Defrauded His Advisory and Prospective Advisory Clients ..... 36

**IV. APPROPRIATE SANCTIONS** ..... 38
A. A Cease-and-Desist Order Is Warranted Given the Facts ..... 38
B. Disgorgement Plus Prejudgment Interest Is Appropriate Because of Respondent's Ill-Gotten Gains ..... 38
C. Civil Penalties Against Respondent Are in the Public Interest ..... 39
D. An Associational Bar Against Respondent Is in the Public Interest ..... 40
**V. RESPONDENT'S APPEAL** ..... 40
A. The Initial Decision Does Not Contain Erroneous Findings of Fact ..... 41
i. The Transactions Were Securities ..... 41
ii. Respondent Did Not Provide OCIE with the Revised Schedule I Listing Fifteen Members of FC 2012 ..... 42
iii. The Summaries of Clients' Testimonies Are Not Factually Erroneous ..... 43
iv. Non-Factual Statements from the Initial Decision Are Not Factually Erroneous ..... 43
v. But for Respondent's Deceit of SFA, No Clients Would Have Participated in FC 2012 ..... 44
B. The Initial Decision Does Not Contain Erroneous Conclusions of Law as Claimed by Respondent in His Opening Brief ..... 45
C. The ALJ Did Not Lack Authority to Conduct the Hearing ..... 45
D. Respondent Had Not Been Denied Due Process ..... 46
E. Respondent's Bias Allegations ..... 47
**VI. CONCLUSION** ..... 48
Certificate of Compliance ..... 50
Certificate of Service ..... 51

## TABLE OF AUTHORITIES

### FEDERAL CASES AND MATTERS

David F. Bandimere, Exchange Act Release No. 76308, 2015 WL 6575665 (Oct. 29, 2015) ..... 45

Blinder, Robinson & Co. v. SEC, 837 F.2d 1099 (D.C. Cir. 1988) ..... 47

Ralph Calabro, Securities Act Release No. 9798, 2015 WL 3439152 (May 29, 2015) ..... 46

Cunanan v. INS, 856 F.2d 1373 (2d Cir. 1988) ..... 46

FTC v. Cement Institute, 333 U.S. 683 (1948) ..... 47

Global Crossing, Ltd. Securities Litigation, 322 F. Supp. 2d 319 (S.D.N.Y. 2004) ..... 31

Harding Advisory LLC, Securities Act Release No 9561, 2014 WL 988532 (Mar. 14, 2014) ..... 47

Horning v. SEC, 570 F.3d 337 (D.C. Cir. 2009) ..... 46

Investors Credit Corp. v. Extended Warranties, Inc., 1989 WL 67739 (M.D. Tenn. 1989) ..... 26

Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296 (2011) ..... 31

Liteky v. United States, 510 U.S. 540 (1994) ..... 47, 48

Raymond J. Lucia Cos., Exch. Act Release No. 75837, 2015 WL 5172953 (Sept. 3, 2015) ..... 45

Marcus v. Dir., Office of Workers' Compensation Programs, 548 F.2d 1044 (D.C. Cir. 1976) ... 48

Massachusetts Fin. Servs., Inc. v. Sec. Investor Prot. Corp., 411 F. Supp. 411 (D. Mass. 1976), aff'd, 545 F.2d 754 (1st Cir. 1976) ..... 28

Mathews v. Eldridge, 424 U.S. 319 (1976) ..... 47

Montford and Company, Inc., et al., Advisers Act Release No. 3829, 2014 WL 1744130 (May 2, 2014) ..... 40

Newmyer v. Philatelic Leasing Ltd., 888 F.2d 385 (6th Cir. 1989), cert. denied, 495 U.S. 930 (1990) ..... 25

Robinson v. Glynn, 349 F.3d 166 (4th Cir. 2003) ..... 22

Rollins v. Massanari, 261 F.3d 853 (9th Cir. 2001) ..... 47

Schweiker v. McClure, 456 U.S. 188 (1982) ..... 47

SEC v. Edwards, 540 U.S. 389 (2004) ..... 23, 26

SEC v. First City Fin. Corp., 890 F.2d 1215 (D.C. Cir. 1989) ..... 47

SEC v. Hansen, 1984 WL 2413 (S.D.N.Y. 1984) ..... 28

SEC v. Kenton Capital, Ltd., 69 F. Supp. 2d 1 (D.D.C. 1998) ..... 39

SEC v. Martino, 255 F. Supp. 2d 268 (S.D.N.Y. 2003), aff'd, 94 F. App'x 871 (2d Cir. 2004) ..... 28

SEC v. Merklinger, 489 Fed. Appx. 937 (6th Cir. 2012) ..... 27

SEC v. Ridenour, 913 F.2d 515 (8th Cir. 1990) ..... 28

SEC v. Steadman, 967 F.2d 636 (D.C. Cir. 1992) ..... 35

SEC. v. W.J. Howey Co., 328 U.S. 293 (1946) ..... 22, 23, 24, 25, 26

Richard C. Spangler, Inc., 46 S.E.C. 238 (1976) ..... 38, 40

Steadman v. SEC, 603 F.2d 1126 (5th Cir. 1979) ..... 38, 40

Tcherepnin v. Knight, 389 U.S. 332 (1967) ..... 22

Timbervest, LLC, Investment Advisers Act Release No. 4197, 2015 WL 5472520 (Sept. 17, 2015) ..... 45

United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975) ..... 22, 26

United States v. Torkington, 874 F.2d 1441 (11th Cir. 1989) ..... 48

Vernazza v. SEC, 327 F.3d 851 (9th Cir. 2003) ..... 37

Warfield v. Alaniz, 569 F.3d 1015 (9th Cir. 2009) ..... 23, 24

Robert G. Weeks, Admin. Proc. File No. 3-9952 ..... 39

Withrow v. Larkin, 421 U.S. 35 (1975) ..... 47

**FEDERAL STATUTES AND REGULATIONS**

15 U.S.C. § 77a(1) ..... 22

15 U.S.C. § 77q(a) ..... 9, 21, 30, 34, 38

15 U.S.C. § 78c(a)(4) ..... 28

15 U.S.C. § 78c(a)(10) ..... 22

15 U.S.C. § 78j(b) ..... 9, 21, 30, 34, 38

15 U.S.C. § 78o(a) ..... 10, 21, 28, 30, 38

15 U.S.C. § 80a-3(a)(1)(A) ..... 36, 37

15 U.S.C. § 80b-2(a)(11) ..... 35

15 U.S.C. § 80b-3(i) ..... 39

15 U.S.C. § 80b-6(1) ..... 9, 34, 35, 36, 38, 45

15 U.S.C. § 80b-6(2) ..... 9, 34, 35, 38, 45

15 U.S.C. § 80b-6(4) ..... 9, 10, 30, 34, 36, 37, 38, 45

15 U.S.C. § 80b-12 ..... 45

26 U.S.C. § 170(h) ..... 25

17 C.F.R. § 201.111(f) ..... 48

17 C.F.R. § 201.450(a) ..... 8

17 C.F.R. § 201.600 ..... 39

17 C.F.R. § 230.501, et seq. ..... 8, 9, 10, 23, 24, 41

17 C.F.R. § 240.10b-5 ..... 9, 21, 30, 34, 38

17 C.F.R. § 275. 206(4)-8 ..... 9, 10, 21, 34, 36, 37, 38

**ADMINISTRATIVE RELEASES**

Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles, Release No. IA-2628, 2007 WL 2239114 (August 3, 2007) ..... 37

## STATE STATUTES

Wyo. Stat. Ann. § 17-29-206 (2010) ..... 32

Wyo. Stat. Ann. § 17-29-705(c) (2010) ..... 32

## LAW REVIEWS

Kenneth Culp Davis, Separation of Functions in Administrative Agencies, 61 Harv. L. Rev. 612 (1948) ..... 46

Pursuant to Rule 450(a), the Division of Enforcement ("Division") respectfully submits its Principal and Response Brief in support of its petition for cross-review of the Initial Decision.

## I. SUMMARY

Between August 2012 and May 2013, Paul Edward "Ed" Lloyd, Jr., CPA ("Lloyd" or "Respondent") made material misrepresentations and omissions to seventeen of his tax-planning clients, including at least four who also were formal investment advisory clients and thirteen who were prospective advisory clients. Specifically, Respondent persuaded his clients to give him $632,500 for deposit into a bank account that he controlled for an alleged investment in a private Regulation D [17 C.F.R. § 230.501, *et seq.*] offering by a third party that intended to acquire an interest in land. The property was being considered either for housing development or for preservation under a conservation easement. Respondent further represented to these seventeen clients that, under the easement scenario, they would obtain tax deductions based on their *pro rata* contributions and in excess of their initial investments. Rather than investing all the clients' funds, however, Respondent invested only $502,500 in the names of fourteen clients and misappropriated the remaining $130,000 for personal expenses, including his own fraudulently inflated personal participation in the scheme. That $130,000 represented the total amount provided by three of his clients: Chris Brown, James "Rusty" Carson III, and Michael Malloy.

Respondent's actions at the time of the investment confirm his intent to misappropriate the $130,000 provided by Brown, Carson and Malloy. Most notably, the Operating Agreement that Respondent drafted for Forest Conservation 2012, LLC, the limited liability company that invested in the third-party Regulation D offering, named only fifteen investors: Lloyd and fourteen of his clients. It did not list Brown, Carson or Malloy. Moreover, when asked by the

broker-dealer offering the Regulation D investment whether Carson was an investor, Lloyd responded unequivocally that Carson was not participating.

After the Commission's Office of Compliance Inspections and Examinations ("OCIE") staff began examining the Forest Conservation investments in approximately March 2013, Respondent took further steps to conceal his scheme. In May 2013, Respondent prepared and distributed to all seventeen of his clients (including the four who also were formal advisory clients) and to himself individual IRS Schedule K-1s that were misstated. To the three tax-planning clients whose money he stole, Respondent prepared Schedule K-1s that allocated a tax deduction that none of the three clients had earned because: (1) their funds were not used to acquire ownership interests in Forest Conservation 2012 in their names; (2) they were not listed on the Forest Conservation 2012 Operating Agreement as members; and (3) they were never identified to, or approved by, the broker-dealer handling the Regulation D offering as accredited investors. For the remaining fourteen clients, Respondent prepared Schedule K-1s that understated the deductions that they should have earned—a result of Respondent having to allocate across all seventeen clients and himself an aggregate tax deduction from the third-party issuer that in actuality was based on Lloyd's use of only fourteen clients' funds, plus his own falsely inflated contribution, to purchase units in the offering.

As a result of this misconduct, Respondent violated Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77q(a)], Section 10(b) of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5], and Sections 206(1), 206(2) and 206(4) of the Investment Advisers Act of 1940 (the "Advisers Act") [15 U.S.C. §§ 80b-6(1), (2) and (4)] and Rule 206(4)-8 thereunder [17 C.F.R. § 275.206(4)-8]. In addition, during 2011 and 2012, Respondent sold interests to his tax and/or advisory clients in

two other Forest Conservation entities. By selling interests in these three entities, Respondent operated as an unregistered broker-dealer by selling away in violation of Section 15(a) of the Exchange Act [15 U.S.C. § 78o(a)].

The ALJ initially assigned to this matter, Judge Foelak, awarded partial summary disposition in favor of Respondent on all claims under the Securities Act and the Exchange Act and Rule 206(4)-8 of the Advisers Act, incorrectly concluding that none of the investments at issue were securities. After a hearing, the new ALJ, Judge Elliot, found that Respondent violated Section 206(4) of the Advisers Act through his misrepresentations to the broker-dealer offering the Regulation D investment. ALJ Elliot rejected the other fraud claims, finding that, through his subsequent cover-up, Respondent had actually delivered what he had initially promised to his clients. However, Respondent's efforts to conceal his scheme, taken only after his selling away was discovered and his fraud was at risk of being exposed, do not eliminate the violations.

## II. FACTS

### A. Introduction

Respondent is a certified public accountant and tax-planner, and, until March 2013, was also a registered representative and associated person of LPL Financial, LLC ("LPL"), a broker-dealer and investment adviser registered with the Commission. During 2011 and 2012, Respondent created three free-standing Wyoming-law LLCs, which he named Forest Conservation 2011, Forest Conservation 2012, and Forest Conservation 2012 II, respectively (I.D. 3, 6-8; T. 692–698, 717, 761–762, and 886).[1] For each of the Forest Conservation entities, Respondent solicited his tax and/or LPL investment advisory clients to contribute funds in order to acquire

[1] References to the Initial Decision are cited as "I.D. __." The transcript of the hearing will be identified as "T. __." Exhibits for the Division will be identified as "Ex. __", and for Respondent Lloyd as "R. __." Respondent's Opening Brief will be identified as "O.B.__."

membership interests in the Forest Conservation entities. (I.D., 6-9; Ex. 121, 123). Lloyd then used these pooled funds to enable the entities to purchase membership units in separate real-estate equity offerings made by third-parties. (I.D. 7, 9-10; Ex. 121, 122, 123). The third-party entities, known as Maple Equestrian, Piney Cumberland Holdings and Meadow Creek (hereinafter, the "Land Entities"), filed Forms D with the Commission (I.D. 6; Ex. 151, 152, 153) and sold real-estate equity interests to accredited investors using a broker-dealer known as Strategic Financial Alliance ("SFA"). (I.D. 6; Ex. 22, 55, 56, 99).

For Forest Conservations 2011 and 2012 II, Respondent charged fees to his clients to participate, making $31,500 in fees from Forest Conservation 2011 and $35,780 from Forest Conservation 2012 II (Ex. 122, 123). As for Forest Conservation 2012, Respondent never communicated anything in writing about any fees to his clients prior to the transaction closing (I.D. 13, 16; T. 1007-1008). Once the offerings closed and all units were sold, the Forest Conservation entities owned equity membership units in the Land Entities that held or planned to acquire a controlling interest in other entities with *land* as their primary assets. (I.D. 6; T. 141, 150, 151, 447, 488, 495 and Ex. 22, 55, 56). The managers of the Land Entities then proposed possible uses for the land in writing, such as a conservation easement allowing for land preservation, or investment development through housing construction. (I.D. 6; Ex. 25, 94, 95, 106, 107). The Land Entities had no obligation to secure a conservation easement for any interest in land they acquired. (I.D. 6; T. 473, 474 and Ex. 22, 55, 56).

The conservation easement option was ultimately voted for *by Respondent* as manager of the Forest Conservation entities (I.D. 8, 12-13; Ex. 29, 93, 108), and by a majority of the other members of the Land Entities, later generating charitable tax deductions that were approximately 4.25 times the value of the membership units sold, consisting of the difference between the

highest-value use of the land (*i.e.,* housing subdivision) minus the value of the land if it were preserved. (I.D. 8, 13; T. 128, 454, 455, 481, 493 and Ex. 8, 27, 121, 122, 123). Respondent's clients, who were sub-investors in the Forest Conservation entities, did not have individual votes – they allowed Respondent to act on behalf of the Forest Conservation entities as the Manager. (Ex. 121, 123).

After the easements were approved, the Land Entities issued Internal Revenue Service (IRS) Schedule K-1s (Form 1065) listing the singular tax deduction for each pooled investment by each Forest Conservation entity. (T. 483, 493 and Ex. 28, 129). Respondent then apportioned the tax deductions earned among the Forest Conservation investors on a *pro rata* basis, resulting in individual tax reductions that significantly exceeded the amount of money investors had contributed to purchase the membership units in the first place. (Ex. 122, 128). As Respondent wrote to one client to lure her into participating: "A $35,000 contribution into the land trust reduces your taxes approximately $53,000." (Ex. 61). Respondent did not disclose his involvement with the Forest Conservation entities to LPL. (I.D. 18; T. 329 – 331, 748).

### B. The Forest Conservation 2012 Fraud

#### i. The Piney Cumberland Offering

In 2012, SFA registered representative Nancy Zak ("Zak") reminded Respondent that, for any LLC that Lloyd formed to pool investor funds, he needed to provide SFA with client account forms for all sub-investors so SFA could ensure that each person was an accredited investor (thereby allowing the offer to them of exempt unregistered securities for sale). (T. 152-154, 454; Ex. 44). Such forms also were used in 2011 when Respondent's first Forest Conservation entity invested in the Maple Equestrian offering. (Ex. 170 – 178). This "accredited investor" paperwork required each of Respondent's clients to sign as an "Investor" and each client's form noted that the

client's "primary investment goal" was a "real estate investment." (I.D. 8-9; Ex. 79, 184). The forms signed by Respondent's clients explained: "This program is for accredited investors only. It involves the purchase of a parcel of undeveloped land." (Ex. 79, 184). The attorney for the Land Entities, Peter Hardin, testified: "This offering was prepared in a way to offer units of membership interest only to accredited investors, because if we had any unaccredited investors we would have had to have complied with heightened disclosure requirements and evaluation of the suitability to those investors." (T. 454).

In the fall of 2012, Zak's office informed Respondent of a new real estate-related offering by Piney Cumberland Holdings ("Piney Cumberland"), for which SFA was the broker. (I.D. 8; Ex. 56). Piney Cumberland sought to acquire a controlling interest, through the raising of investor funds, in a tract of undeveloped land in Tennessee. (T. 154-156, Ex. 56). Respondent solicited his advisory and tax clients to contribute investments to Forest Conservation 2012 ("FC 2012"), with Respondent ultimately depositing funds from seventeen clients between October 1, 2012 through December 4, 2012 into the FC 2012 bank account at BB&T, which he controlled. (T. 781; Ex. 123). On December 7, 2012, Respondent deposited $16,802 of his own funds into the FC 2012 bank account to participate personally in FC 2012, *even though LPL policy strictly prohibited advisors from investing in private securities transactions with their clients.* (I.D. 10; T. 310; Ex. 82). However, on December 10, 2012, Respondent advised SFA that his personal investment in Forest Conservation 2012 was $41,052. (T. 543, 544, and Ex. 88). The difference between Respondent's actual deposit and the amount he claimed to SFA as his personal investment was $24,250. (I.D. 11; T. 911, Ex. 187). Although he collected funds from seventeen clients and himself, including four of his formal LPL advisory clients (Vernon "Ray" Branch, Timothy Goss, Leslie "Lee" Powell and Larry Price), Respondent initially provided SFA with a FC 2012

Operating Agreement that listed himself as the only member holding 100 percent of the ownership interests (I.D. 11; T. 181, Ex. 86, 123).

### ii. Respondent Leaves Out Brown, Carson and Malloy from FC 2012

When SFA told Respondent that he needed to disclose the names of all his clients who were investing in FC 2012, Respondent, on four occasions during December 10-11, 2012, provided SFA with Operating Agreements and other paperwork that only contained the names of fifteen investors (fourteen investors plus himself), instead of the full list of eighteen people who actually contributed money to the FC 2012 bank account (I.D. 12; T. 183 – 190, Ex. 88, 90, 91, 191). Each of the fourteen listed client investors was noted by Respondent on the Operating Agreements as having a percentage of ownership in FC 2012 based on that individual's entire investment (the full check amount *minus no fees for 2012*). (Ex. 88, 90, 91, 191). Thus, Respondent represented to SFA that only he and 14 others had invested in FC 2012. Had there been any omission or inaccuracy on the schedule of investors and had it been discovered by SFA or the Piney Cumberland issuer, then FC 2012 would not have been allowed to invest in Piney Cumberland (I.D. 12; T. 188-189, 469, 545).

On December 11, 2012, Respondent certified that the final Operating Agreement he provided to SFA, containing a list of fifteen people whom he identified as members of FC 2012, was a true, complete and correct copy of the Agreement (I.D. 12; T. 191 – 194, 467, Ex. 187, 190, 191). Once the certified Operating Agreement was approved by SFA and by the attorney who handled the Piney Cumberland Holdings offering, the offering closed (T. 471-472). However, Respondent did not disclose to SFA – in the four FC 2012 investor lists that he provided – the names of the three other clients who had already given money to Respondent to invest in FC 2012: Christopher Brown, James "Rusty" Carson III, and Michael Malloy (I.D. 12; T. 187-194, Ex. 88,

90, 91, 191). The total amount of money Respondent had received from Brown, Carson and Malloy was $130,000, with Brown and Malloy each giving $50,000 and Carson giving $30,000. (T. 369, 370, and Ex. 47, 59, 77, 187).

### iii. The Transaction Occurs and FC 2012 Acquires Piney Cumberland Membership Units

Respondent wire-transferred funds from the FC 2012 bank account to Piney Cumberland on December 7, 2012. (Ex. 83). The transaction closed and FC 2012 formally acquired 228 units of ownership in Piney Cumberland on December 11, 2012. (Ex. 192). Lloyd also transferred the remaining funds in the account to entities that he or his wife owned and controlled, as follows: a $2,000 check to Corporate Solutions, Inc. on November 28, 2012; a $22,750 check to Benefit Administration Services on December 20, 2012[2]; a $22,000 check to Benefit Administration Services on December 30, 2012; and a $59,000 check to Ed Lloyd and Associates, PLLC, on December 31, 2012. (Ex. 67, 102, 110, 109). The total amount of these checks was $105,750. (I.D. 13; Ex. 187). That amount, plus the $24,250 fraudulent increase in Respondent's personal investment in FC 2012, equals $130,000, the precise amount of money that Respondent received from Brown, Carson and Malloy, but failed to disclose to SFA. (Ex. 187).

Although Respondent never provided any accredited investor paperwork to SFA for Brown or Malloy, he initially provided *incomplete* accredited investor paperwork to SFA for Carson on which Carson had noted that he worked in the securities industry. (Ex. 79). Zak sent an e-mail to Respondent requesting additional information about Carson, including a "Form 407" letter from

---

[2] Respondent told Division staff during his investigative testimony that Benefit Administration Services ("BAS") is a separate business that Lloyd owns and operates, providing "analysis and research work" to Lloyd's other business endeavors, such as the Forest Conservation entities. However, when pressed for details of the specific work BAS performed in order to be paid, Lloyd explained: "So to answer your question, do I have something tangible? No. ***It's all research that I have in my brain ... I just deem whatever I feel appropriate for [BAS] to be paid and that's what they're paid.***" (Emphasis added). (Ex. 147, at pages 190 – 192).

Carson's securities employer indicating that it was aware of and approved of Carson's planned investment (Ex. 193). Lloyd responded with an e-mail to Zak saying that Carson was "OUT." (I.D. 11; Ex. 84 (Capitalization in original)). When Zak followed-up with an e-mail to Respondent to confirm that "Carson is not participating, correct?," Lloyd replied with an e-mail that read: "Correct." (I.D. 11; Ex. 84). Respondent's e-mail exchanges with Zak occurred on December 7, 2012, only three days after his December 4, 2012 deposit of Carson's $30,000 check into the FC 2012 bank account, and three days prior to advising SFA that the amount of his personal contribution was $41,052 (I.D. 11, Ex. 88, 123).

Respondent did not provide finalized accredited investor paperwork to SFA for Carson because he never asked Carson to provide a Form 407 letter from his employer. (T. 808-809). As Respondent explained at the hearing, Respondent knowingly and intentionally took Carson out of the FC 2012 offering and kept Carson's money. (T. 815, 912-913, 921). In fact, Respondent admitted that he misled Carson, taking his money but then unilaterally deciding to remove him as an investor in FC 2012 without returning his money:

> **Q So you never shared with Mr. Carson your determination that he was going to be out of the offering. Right?**
>
> A Correct.
>
> **Q And you kept his money. Right?**
>
> A Correct.

(T. 815). Further, Respondent claimed that he failed to inform Zak of the two $50,000 checks that he received from Brown and Malloy because Lloyd "forgot." (T. 1002). Respondent testified that this was the only time he has ever forgotten that he received multiple $50,000 checks during his career. (T. 1004).

## C. Respondent's Cover Up

### i. Respondent Misleads the National Exam Program

Respondent met with members of OCIE's National Exam Program in March 2013, roughly three months after concluding the investment by FC 2012 in Piney Cumberland. (I.D. 19). In response to the Exam Program's request for documents relating to these transactions, Respondent did not provide the Exam Program with the revised FC 2012 Operating Agreement listing fifteen investors that Respondent had provided to SFA on multiple occasions in December 2012. (I.D. 20; Ex. 123). Rather, Respondent, in a March 2013 letter from his attorney, provided the Exam Program with the version of the Operating Agreement erroneously listing him as the sole member of FC 2012. (I.D. 20; T. 575 and Ex. 89, 123). Respondent also provided to the Exam staff a newly created list of eighteen investors for FC 2012 (including Brown, Carson and Malloy), consisting of Lloyd and seventeen clients whom he now claimed had all been charged a tax-planning fee to participate. (Ex. 123). As a result, the Exam Program could match up all the deposits in the FC 2012 bank account records with the eighteen member list, but could not see the fifteen-member list that Respondent gave SFA on four occasions.

Although Respondent, the year before, had documented in writing the fees that he charged to Forest Conservation 2011 investors in connection with the Maple Equestrian offering (Ex. 2, 3, 4, 5, 156), he never did so with respect to any of the FC 2012 investors prior to the transactions. (T. 1007 – 1008). In his letter to OCIE, Lloyd, for the first time, wrote of fees related to clients participating in FC 2012. These fees for FC 2012, which Respondent listed in his March 2013 letter to the Exam Program, varied by investor, ranging between 14 percent and 21 percent of the total check amounts provided by them (or $4,750 to $8,500). (Ex. 123 at pages 67, 69, 72). This was unlike the $4,500 fee that Respondent previously charged to most of the Forest

Conservation 2011 investors (though some received invoices for $5,000 in fees for 2011). (T. 581 and Ex. 2, 3, 4). In his investigative testimony, Respondent explained that the fees he charged were based on "***more of an art, if you will, than a science***" and were essentially calculated using his "***judgment of what I felt at the time would be appropriate.***" (Emphasis added) (Ex. 144, at pages 64, 68).

According to the March 2013 letter and attachments sent to the Exam Program, Respondent's purported fees charged to FC 2012 investors totaled $105,750 – the *exact* amount of the four checks Respondent wrote from the FC 2012 bank account to his and his wife's businesses months earlier in late 2012. (Ex. 187). Respondent also provided documents to the Exam Program that listed his personal investment in FC 2012 as $16,802, the amount he actually deposited into the FC 2012 bank account, thereby abandoning the $24,250 of stolen funds he claimed months earlier when he told SFA his personal investment was $41,052. (T. 578; Ex. 123, pages 5, 72, 73). Respondent did not reveal that he was involved in the Forest Conservation entities as an outside business activity until he was confronted by the Exam staff which had come across Forest Conservation accredited investor paperwork during an exam of SFA (thereafter, Respondent admitted to the Exam staff that he had not disclosed his involvement in the Forest Conservation entities to LPL). (T. 554 - 561).[3] He falsely claimed that none of the Forest Conservation investors was an LPL advisory client. (I.D. 20; T. 556, 573, 574). Respondent further claimed during his meeting with OCIE staff that all of the funds that he raised from his clients went towards their investments, which was consistent with the "amount of purchase" figures reported for them on the accredited investor paperwork that he previously submitted to SFA. (T. 558). However, this

[3] Lloyd also concealed his involvement in the Forest Conservation entities as an outside business activity from LPL branch examiner Erin Dethlefsen during her February 2013 branch examination of his LPL office (T. 329-331).

was inconsistent with the position he subsequently advanced in his letters to the Exam Program where he argued that "fees" came out of the clients' checks. (Ex. 123 at pages 67, 69, 72).

ii. **Respondent Uses False Tax Documents to Mask His Scheme**

After Respondent became aware that the Exam Program was looking into his Forest Conservation entities in March 2013, he took additional steps to conceal his scheme. Specifically, after FC 2012 received its tax deduction based on its ownership interest in Piney Cumberland, Respondent prepared in May 2013 and distributed to all seventeen of his clients and to himself individual IRS Schedule K-1s that were misstated. (Ex. 128). To the three tax-planning and prospective advisory clients whose money he misappropriated (Brown, Carson and Malloy), Lloyd gave Schedule K-1s that allocated a tax deduction that none of them had earned because their funds were not used to acquire ownership interests in FC 2012 in their names, they were not listed on the final FC 2012 Operating Agreement (dated December 7, 2012) as owning any interests in the entity, and they were never identified to, *nor approved by*, SFA as accredited investors. (Ex. 88, 90, 91, 123, 128, 187, 191).

To the remaining fourteen clients, Respondent sent Schedule K-1s that understated the deductions that they should have earned—a result of Respondent having to allocate across all seventeen clients an aggregate tax deduction from Piney Cumberland that in actuality was based on Respondent's use of only fourteen clients' funds, plus his own falsely inflated contribution, to purchase membership units in Piney Cumberland. (Ex. 123). As a result, these fourteen clients – including the four formal advisory clients (Branch, Goss, Powell and Price) and the other ten tax and prospective advisory clients – should have received larger tax deductions than they ultimately acquired. (Ex. 88, 90, 91, 123, 128, 187, 191). (Tax client Shawn Ashley Hooks testified in the hearing that she was also an advisory client. (T. 1076)).

### iii. Respondent Misleads Enforcement Staff and Clouds Clients' Memories

Respondent's cover-up did not end with the false tax documents. During his sworn investigative testimony, Respondent testified that he did not know why the list of FC 2012 investors that he gave SFA on four occasions in 2012 contained fifteen names while the list that he gave to the Exam staff in March 2013 had eighteen names. (Ex. 144). Respondent also could not explain why he told SFA he was personally investing $41,052 in FC 2012 but later only claimed $16,802 to the Exam Program, nor could Respondent account for the difference. (T. 423 – 430, Ex. 144). Respondent's memory markedly improved at the hearing. (T. 815-816, 910-925, 1002).

Further, when the Division issued document subpoenas to Respondent's clients during its investigation, Respondent gave many of his clients an after-the-fact story about the "fees" they were supposedly charged, resulting in almost identical language in the clients' production cover letters to the Division. (T. 426 – 430; Ex. 144 at page 126; Ex. 130-143, 168-169). Lloyd testified that he "reminded" his clients about the fees he purportedly charged them when he spoke to them after they received their subpoenas because they would not have remembered the fee amounts on their own. (Ex. 144 at p. 126). He further admitted that he provided his clients with certain information used in their respective document production cover letters to the Division, including the fee amounts he purportedly took from their investment checks. (Ex. 144, p. 127). Respondent's cover-up effort fell flat at the hearing in this matter, as some clients called by Respondent could not recall the fee amounts that Lloyd now argues he charged to them for FC 2012.[4]

[4] Dennis Hall testified that he could not truthfully say in 2015 that he knew at the time when he invested in 2012 whether his check to FC 2012 included a fee to Lloyd (T. 1173, 1174). Leslie "Lee" Powell testified that, while "I don't recall specifically off the top of my head" what the fee amount was for FC 2012, "I would say [it was] between 4 and 5,000...." (T. 640, 641). Powell further testified that Lloyd's reported fee of $8,500 for Forest Conservation 2012 seemed high to him (T. 670).

After the Division issued its Wells Notice to Lloyd on June 17, 2014, Respondent continued his cover-up scheme by urging his clients to sign an Amended Operating Agreement, adding Brown, Carson and Malloy. However, the basis for Respondent's request was his now-discredited contention that he previously failed to include Brown, Carson and Malloy as investors due to a "scrivener's error." (I.D. 21). This was not truthful, as Respondent explained at the hearing that he intentionally removed Carson from FC 2012. (T. 815-816, 912-913). Finally, Respondent convinced some, *but not all*, of his clients to sign affidavits prior to the hearing in Charlotte swearing that they received the outcome they always expected from FC 2012 – even though he admitted in his sworn testimony that his clients could not remember such details and he had to remind them. (R. 39; Ex. 144 at page 126). These affidavits were predicated upon Respondent's knowingly false explanation to his clients of a "scrivener's error." (R. 39). Brown and Malloy did not provide signed affidavits for Lloyd. (Ex. 47, 59, and R. 39).

## III. DISCUSSION

### A. The Transactions Were Securities Under the Howey Test

Judge Foelak erroneously granted partial summary disposition in favor of Respondent on the Division's claims under Sections 15(a) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and Section 17(a) of the Securities Act, and Advisers Act Rule 206(4)-8. Judge Foelak reasoned that the investments that Respondent offered (*i.e.* interests in the Forest Conservation entities) were not securities because they ultimately led to tax deductions. This ruling was erroneous, as the subsequent conservation of land does not undo a concluded purchase of real-estate equity interests, nor does it undo a concluded purchase of membership interests in an LLC. Further, as the Division demonstrated in its offer of proof at the hearing, the Piney Cumberland land could have been developed for profit through housing development, thereby presenting a

possible expectation of profit. Finally, the tax deductions earned by Respondent's clients were profits because they resulted in financial returns which were greater than the money initially invested.

### i. The Howey Test for Investment Contracts

The touchstone of any analysis as to whether a particular instrument is a security under Section 2(a)(1) of the Securities Act of 1933 ("Securities Act") and Section 3(a)(10) of the Securities Exchange Act of 1934 ("Exchange Act") is the substance rather than the form of the transaction, with an emphasis on economic reality. SEC. v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946); United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 848 (1975). Investment schemes may fall within several of the categories of instruments included within the definition of a security. Tcherepnin v. Knight, 389 U.S. 332, 339 (1967). Federals securities laws define the term "security" as including investment contracts. The Howey court, *supra*, defined the term "investment contract" as a contract, transaction or scheme whereby a person: (1) invests his money; (2) in a common enterprise; and (3) is led to expect profits (4) solely from the efforts of the promoter or a third party. See also Robinson v. Glynn, 349 F.3d 166, 170 (4th Cir. 2003).

In her ruling, Judge Foelak found that elements (1) and (2) were met, but concluded that elements (3) and (4) were not shown because Respondent's clients gave money to receive a tax deduction based on the conservation of land. However, this land could only be preserved *after* ownership units in the real-estate equity offerings were acquired. Judge Foelak's reasoning was ill-founded and contrary to case law. The Howey case and its progeny are not constrained or defined by the specific outcomes that follow a securities transaction. In fact, the Howey court explained that its definition of "investment contract" is understood to embody "a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes

devised by those who seek the use of the money of others on the promise of profits." Howey, 328 U.S. at 299. The motives of investors and the types of investments that appeal to them may vary considerably, but an investment of money occurs under Howey where purchasers commit "their assets in return for promised financial gain." Warfield v. Alaniz, 569 F.3d 1015, 1023 (9th Cir. 2009) (finding charitable gift annuities were investment contracts under Howey and rejecting Defendant's argument that investors lacked intent to realize financial gain because of the presence of a charitable donation).

Further, the Supreme Court has made clear that the term "profits" in the Howey test is not to be read narrowly, but is intended to be understood "in the sense of income or return, to include, for example, dividends, other periodic payments, or the increased value of the investment." SEC v. Edwards, 540 U.S. 389, 394 (2004). In Edwards, the Court also noted that its past descriptions of "profits" were "illustrative" and were not "an exclusive list." Id. At 396. The Court explained it would not be bound by its past descriptions of "profits" used in "passing dictum that would frustrate Congress' intent to regulate all of the 'countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.'" Edwards, 540 U.S. at 396 (quoting Howey, 328 U.S. at 299); see also Warfield, 569 F.3d at 1023-1024.

**ii. Profits Were Possible from the Development or Sale of the Land**

Here, there were multiple ways in which Respondent's clients could expect profits under this analysis. First, as demonstrated in the Division's offer of proof at the hearing, the clients could expect profits from their participation in the Forest Conservation entities' plans to buy into the Regulation D offerings because the offering summaries explained that the Land Entities intended to acquire a controlling interest in *land* (*i.e.*, real property interests) which, under one scenario, could be developed for profit through the construction and sale of residential lots. (T. 129 – 140,

155; Ex. 22, 55, 56). Such an offering tends to induce purchases because of the possibility of profits from the increased value of the land, which would be developed and marketed and sold by individuals other than Respondent's clients.

As noted above, Lloyd's clients signed accredited investor paperwork stating that their "primary investment objective" was "real estate investment." (Ex. 79, 184). Judge Foelak dismissed this possibility of profits from housing development as "boilerplate" and "pro forma." However, as the Warfield court explained, the Howey test is satisfied where there is "any" expectation of profit. Warfield, 569 F.3d at 1020. Here, the possibility of profit from development was anything but remote. The Land Entities provided members with Investment Proposals, based on professional land appraisals, outlining in writing the possibility of multi-million dollar appreciations of the Maple Equestrian, Piney Cumberland and Meadow Creek lands. (Ex. 25, 95, 107). The proposals suggested an "investment strategy" of "holding the Property for appreciation and eventual sale to a developer who could execute a development plan of its choosing." (Ex. 25, 95, 107).

Further, those involved in creating and selling the Regulation D offerings in this matter believed they were selling securities. (T. 443-444, 447, 454). The Maple Equestrian, Piney Cumberland Holdings and Meadow Creek offerings were specifically "offered and sold in reliance on the exemptions from the registration requirements provided by" the Securities Act of 1933. (Ex. 22, 55, 56).[5] Forms D were filed with the Commission for each. (Ex. 151, 152, 153). Respondent used similar language on the face page of his Operating Agreements for the Forest Conservation entities. (Ex. 123). When the subscriptions closed in December 2012, conservation easements had *not* yet been voted upon, granted or filed for the underlying real estate (T. 473, 474,

[5] When asked at the hearing whether the offering summaries for the Land Entities gave "any hint that this could be a security," Respondent replied: "***I guess you could say yes.***" (T. 745 (emphasis added)).

502) and Respondent's clients did not receive any tax deductions until May 2013. (T. 887-888; Ex. 125, 126). Upon the completion of the purchase of ownership units, the Forest Conservation entities – and Respondent's clients who were members – owned membership interests in third-party entities. (T. 473, 474, 502). The decision to develop the land or conserve it had to come later, *after* each securities transaction was finalized.

As explained by Internal Revenue Code Section 170(h), a "qualified conservation contribution" means a contribution of a "qualified real property interest" to a qualified organization exclusively for conservation purposes. FC 2012 first had to acquire a "real property interest" in Piney Cumberland, *i.e.*, a secured equity interest involving land, in order to be able to receive a tax deduction from any subsequent conservation easement. Finally, even though the conservation easement option was *later* selected for the land, the investors continue to retain a percentage ownership interest in the underlying real estate today, which could be sold at a later date for a possible financial return. (T. 485).

### iii. Profits Were Possible through Net Financial Gain Based on Tax Deductions Following the Land Preservation

Respondent's clients also expected profits from the efforts of others because Respondent induced clients to invest by emphasizing they would receive a tax deduction and a corresponding decrease in income taxes owed of greater value than each client's initial investment, *i.e.*, a net profit earned from the anticipated conservation easements. (T. 761 and Ex. 54, 61). Courts have 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 "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).

Here, Respondent's clients made it clear that the possible tax benefits from investing due to the anticipated conservation easements were their primary reason for investing. This stands in contrast to Forman, 421 U.S. at 853-58, where 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." In this matter, Respondent's clients expected "profits" – or financial gain – in the form of tax deductions that were larger than the money they invested to participate in the Forest Conservation entities. This understanding of "profits" is squarely in line with the Supreme Court's broad definition of "profits" in the Edwards opinion, which includes "financial returns on ... investments." Edwards, 540 U.S. at 396.

The financial return achieved through the tax deductions in this matter exists in lowering one's tax bill through a tax deduction that results in greater tax savings than the initial amount of money used to buy membership in the Forest Conservation entities. As Respondent wrote to his client Shawn Ashley Hooks: "***A $35,000 contribution into the land trust reduces your taxes approximately $53,000.***" (Ex. 61) (Emphasis added). Ms. Hooks' primary inducement for

participating in FC 2012 was for this financial gain, as she explained at the hearing: "It was really a way to alleviate tax – tax implications from my tax returns." (T. 1058). Her fellow investor in FC 2012, Larry Price, explained a similar rationale for participating in the offerings: "Well, Mr. Lloyd advises me each year on taxes and what would be ***an investment to get a tax deduction***, and that's when he told me about that." (T. 1107) (Emphasis added). Perhaps no client of Respondent explained the financial return from participating in FC 2012 better than Mark Losby, who testified: "I would make a contribution to the conservation and in return, I would get tax credits that would offset my tax responsibility more than my contributions. ***That would be where I would come out ahead.***" (T. 930) (Emphasis added). In short, Respondent's clients invested money in a common enterprise for financial gain.

**iv. Respondent's Clients Were Passive Investors**

Respondent's clients' only meaningful role was to write checks and wait for their *pro rata* financial return. Once Respondent's clients provided their investment funds to the Forest Conservation entities, they had no role in the success or failure of the ventures. Respondent handled the funds, made the investments, and ultimately prepared the clients' individual tax returns based on the Land Entity *pro rata* deductions. The clients were passive investors relying on the efforts of others to generate their profits. (Ex. 121, 123). 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). As such, the Commission should reverse Judge Foelak's partial grant of summary disposition finding that the transactions in this matter were not securities. The Forest Conservation interests sold by Respondent clearly were investment contracts.

## B. Respondent Acted as an Unregistered Broker-Dealer

Because the transactions here were securities, Respondent acted as an unregistered broker-dealer by selling interests in the Forest Conservation entities to his clients. Section 3(a)(4) of the Exchange Act defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others." The phrase "engaged in the business" connotes a regular participation in securities transactions and can be evidenced by such things as holding oneself out as a broker-dealer or receiving transaction-based compensation. See e.g. Massachusetts Fin. Servs., Inc. v. Sec. Investor Prot. Corp., 411 F. Supp. 411, 415 (D. Mass. 1976), aff'd, 545 F.2d 754 (1st Cir. 1976); SEC v. Hansen, 1984 WL 2413, at *10 (S.D.N.Y. 1984).

Section 15(a)(1) of the Exchange Act prohibits a broker or dealer from effecting any transactions in, or inducing or attempting to induce the purchase or sale of, any security without registering as, or associating with, a registered broker-dealer, unless such broker or dealer (1) is registered with the Commission in accordance with Section 15(b) of the Exchange Act; (2) in the case of a natural person, is associated with a registered broker-dealer; or (3) satisfies the conditions of an exemption or safe harbor. SEC v. Martino, 255 F. Supp. 2d 268, 283 (S.D.N.Y. 2003), aff'd, 94 F. App'x 871 (2d Cir. 2004). The registration exemption for associated persons is not available if an associated person engages in securities transactions that are outside of the scope of his employment with the registered firm, and the registered firm is unaware of or has not approved of the associated person's involvement in the transactions. This practice is called "selling away." A registered representative who is selling away may be liable for violations of Section 15(a). See, e.g., SEC v. Ridenour, 913 F.2d 515, 517 (8th Cir. 1990) (bond salesman violated Section 15(a)(1) by engaging in a series of undisclosed, private securities transactions as part of private bond business of which registered firm had no knowledge or opportunity to supervise).

At the time of his fraud, Respondent was a registered representative and an associated person of LPL. (T. 277, 278, 329 – 331, 698). With regards to the Forest Conservation entities, Respondent acted as a broker-dealer by: (1) actively soliciting and inducing individuals to invest in the Forest Conservation entities (T. 729-730, 746, 762; Ex. 5, 51, 53, 54, 61); (2) requiring investors to pay him transaction-based compensation for the offerings in the cases of Forest Conservation 2011 and 2012 II, respectively (T. 755-756, 886; Ex. 2, 3, 4, 121, 122, 123), while misappropriating client funds as his compensation for FC 2012 (T. 383, 815, 912, 913, 1027 and Ex. 187); (3) handling investor funds in bank accounts which Lloyd controlled (T. 730; Ex. 121, 122, 123); and (4) purchasing ownership units in the real estate offerings using the investors' pooled funds (Ex. 24, 83, 104). Respondent testified that he created and sold investments in the Forest Conservation entities in 2011 and 2012, and then used the funds raised to purchase ownership units in the real estate offerings without informing or seeking approval from LPL. (T. 725, 764-765; Ex. 144 at pp. 72 - 75).

Further, Respondent admitted at the hearing that he incorrectly completed accredited investor paperwork for himself as an investor in the Forest Conservation entities, denying that he worked in the securities industry in 2011 and 2012. (T. 747-751, 785-786; Ex. 75, 174). As a result, SFA did not know that Respondent worked for a broker-dealer (LPL) and was required to provide a Form 407 in which LPL would have had to consent to Respondent's participation in the offerings. (T. 748). As such, Respondent was "selling away" from LPL in 2011 and 2012 and, therefore, was engaged in securities transactions that were not within the scope of his employment with the registered firm, and LPL was unaware of and did not approve of Respondent's involvement in these transactions. (T. 329 – 331). Respondent received $31,500 in fees from the Forest Conservation 2011 offering participants and $35,780 in fees from FC 2012 II participants.

(Ex. 121, 122, 123). He further misappropriated $130,000 from Brown, Carson and Malloy as part of the FC 2012 scheme. (Ex. 187). As a result, Respondent violated Section 15(a) of the Exchange Act by acting as a broker-dealer without registration.

### C. Respondent Violated the Antifraud Provisions of the Securities Act and the Exchange Act

As noted above, Judge Elliot found that Respondent violated Section 206(4) of the Advisers Act because of the material misrepresentations and omissions that Respondent made to SFA concerning which clients had given money to participate in FC 2012. (I.D. 30). Because the underlying transactions regarding FC 2012 were securities, Respondent's conduct involving SFA also violated both Section 17(a) of the Securities Act of 1933 (the "Securities Act"), prohibiting fraud in the offer or sale of a security by the use of interstate commerce or the mail, as well as Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder, prohibiting fraud in connection with the purchase or sale of securities by use of interstate commerce or the mail.

Respondent also violated Section 206(4) of the Advisers Act, Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, through: (1) the misappropriation of investor funds and (2) the use of false tax documents to cover up the scheme. Specifically, Lloyd misappropriated investor funds from the FC 2012 bank account, but was forced to cover up his scheme by using false tax documents to shield his actions. Judge Elliot rejected this conclusion, holding that Brown, Carson and Malloy ultimately received tax deductions "in approximately the amounts they should have received" and determined that Lloyd's actions "may have merely been part of a scheme to cut corners and muddle through, rather than a scheme to steal or convert his clients' assets." (I.D. 28).

This conclusion stands in contrast to the evidence presented at the hearing. Lloyd knowingly and on his own made misleading statements and/or omissions to SFA and to his clients as to the clients' participation and amounts of participation in FC 2012, as well as Lloyd's own amount of investment in FC 2012. (T. 815-816, 913, 921-922, 925; Ex. 61, 88, 90, 91, 123, 128, 191). See Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2302 (2011) (holding that securities fraud liability for misleading statements is properly alleged against "the maker of a statement" who is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."). Further, by misappropriating investor funds, Lloyd committed deceptive or fraudulent acts. See Global Crossing, Ltd. Securities Litigation, 322 F. Supp. 2d 319, 335 (S.D.N.Y. 2004) (finding a cause of action for securities fraud exists "for behavior that constitutes participation in a fraudulent scheme, even absent a fraudulent statement by the defendant.").

**i. Respondent Misappropriated Client Funds**

Respondent clearly misappropriated the funds of Brown, Carson and Malloy from December 2012 until March 2013, when his cover-up efforts began. It was in December 2012, on four occasions that Respondent provided SFA with a list of fifteen participants in FC 2012, omitting any participation by Brown, Carson and Malloy, all of whom had already provided checks that Respondent himself deposited into the FC 2012 bank account which he controlled. (T. 781; Ex. 88, 90, 91, 123, 191). Respondent never gave to SFA any finalized accredited investor paperwork for Brown, Carson and Malloy. Further, the finalized FC 2012 Operating Agreement of December 7, 2012 and list of investors which Lloyd certified as "true, complete and correct" did not contain Brown, Carson or Malloy. (Ex. 191). Therefore, Respondent kept Brown, Carson and

Malloy from participating in the offering and from acquiring ownership interests in the FC 2012 entity. (T. 183, 184, 189, 191, 194, 195 and Ex. 90, 91, 191).

If one were to credit Respondent's argument that Brown, Carson and Malloy were always members of FC 2012, then the "amount of purchase" listed on the accredited investor paperwork for the other fourteen clients was incorrect, as those amounts were based on the full amount of the clients' checks to FC 2012 with no fees taken out. (Ex. 184). Respondent has attempted an end-run around this reality by convincing his clients to execute an Amended Operating Agreement in 2014 – after receiving a Wells Notice – which purported to add Brown, Carson and Malloy to FC 2012. (Ex. 150). However, Respondent convinced clients to sign that amended agreement based on his now discredited "scrivener's error" tale. (T. 814-815, 912-913, Ex. 150).[6]

As noted above, Respondent intentionally removed Carson as an investor in FC 2012, although he never told Carson that he had done so and he kept Carson's money anyway. (T. 815, 912, 913). When Zak asked Respondent whether Carson was participating in the FC 2012 offering, Respondent replied unequivocally that Carson was "OUT." (Ex. 84). Respondent inflated his own personal contribution to FC 2012 by $24,250 and used the other $105,750 to issue checks to his and his wife's businesses in 2012, resulting in the misappropriation of client funds roughly three months before Respondent was examined by OCIE staff. Those two sums -- $24,250 and $105,750 – total the exact amount that Respondent misappropriated from Brown, Carson and Malloy, which is $130,000. The numbers matched to the penny and show this was no mistake. Judge Elliot even conceded in his Initial Decision that stealing the $130,000 from Brown, Carson

[6] Wyoming Law allows for LLC records filed with the state to be corrected "if at the time of filing the record contained inaccurate information or was defectively signed." Wyo. Stat. Ann. § 17-29-206 (2010). However, Wyoming law does not condone after-the-fact corrections or implied readings of an LLC operating agreement *to conceal a fraud.* The provision of fraudulent information to the state in LLC filings is grounds for the deeming of the LLC as defunct, transacting business without authority, and in forfeiture of its articles of organization. Wyo. Stat. Ann. § 17-29-705(c) (2010).

and Malloy "may have been Lloyd's actual intention." (I.D. 28). However, just because Respondent later engaged in a cover-up where most of the money was given back through sham tax deduction paperwork does not mean the misappropriation from late 2012 until March 2013 never took place. For roughly three months, from early-December 2012 until mid-March 2013 when Respondent sent his letter to the Exam Program, no writing existed to substantiate Respondent's explanation as to the wildly varying fees he now claims he charged to his clients for FC 2012. (Ex. 123). In fact, the only explanation was that Respondent had misappropriated funds from his clients, duped SFA as to his personal investment amount and needed to cover it up. The misappropriation of the funds occurred and Respondent should be held accountable.

**ii. Respondent Used False Tax Documents to Cover Up His Scheme**

After the National Exam Program asked for underlying documents related to FC 2012, Respondent realized that he would also have to cover up his misappropriation through his tax preparation work for his clients. In May 2013, approximately two months after the OCIE exam of his office, Respondent issued Schedule K-1s to all seventeen clients who gave money to the FC 2012 bank account. To the fourteen clients who were approved as accredited investors by SFA, Respondent provided Schedule K-1s reflecting tax deductions that were lower than these fourteen clients should have earned based on the final FC 2012 Operating Agreement and the "Amount of Purchase" contained in the accredited investor paperwork given to SFA for each of those fourteen clients. (Ex. 123, 128, 184, 187, 191). As for the other three clients (Brown, Carson and Malloy), Lloyd gave them K-1s to which they were not entitled because they never were submitted to SFA for review and approval. (Ex. 123, 128, 184, 187, 191).

Respondent's cover-up of the misappropriation should not be misunderstood as cutting corners and muddling through a busy month of work. Respondent's life and livelihood are based

on his expertise with numbers and, as a professional accountant with hundreds of clients, he knew the difference between a list of fifteen names and a list of eighteen names adding up to the same dollar amount. As Respondent admitted at the hearing, in hindsight, he could have simply asked Carson for a Form 407 letter from his broker and then had Carson join the Forest Conservation 2012 II investment in Meadow Creek which took place the week after the Piney Cumberland offering closed in December 2012. (T. 924). But Respondent did not do this, just as he did not inform SFA of his own work with LPL, which would have required Respondent himself to provide a Form 407 from LPL in order for Respondent to participate personally in the Piney Cumberland offering as a FC 2012 sub-investor. (T. 748, 785-786). Lloyd's motive for not asking LPL for permission to participate was to avoid being caught in violation of LPL policy. As LPL Branch Examiner Erin Dethlefsen explained in her testimony: "Advisers are strictly forbidden from investing in private securities transactions with their clients. This is a violation of LPL Financial Policy that can result in immediate termination." (T. 310) (Emphasis added). Because of Respondent's knowing and intentional misappropriation of investor funds and creation of false tax documents, the Commission should find that Respondent violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(4) of the Advisers Act.

### D. Respondent Violated the Prohibited Transaction Provisions of the Advisers Act

Because Respondent committed fraud in these securities transactions on his clients through the misappropriation of investor funds and the use of false tax documents, Respondent also violated Sections 206(1) and 206(2) of the Advisers Act and Rule 206(4)-8 thereunder. Section 206(1) makes it unlawful for an investment adviser to employ any device, scheme or artifice to defraud any client or prospective client. Section 206(2) makes it unlawful for an investment

adviser to engage in any transaction, practice or course of business that operates as a fraud or deceit upon any client or prospective client. Both Sections 206(1) and 206(2) of the Advisers Act apply to all investment advisers meeting the statutory definition, regardless of their registration status. Section 206(1) requires a showing of scienter; Section 206(2) does not. SEC v. Steadman, 967 F.2d 636, 641 n.3, 643 n.5 (D.C. Cir. 1992).

**i. Respondent Was an Investment Advisor in the Relevant Transactions**

An investment adviser is defined by Section 202(a)(11) of the Advisers Act as someone who, in return for compensation, engages in the business of advising others as to the advisability of investing in, purchasing, or selling securities. Respondent admitted that two investors in Forest Conservation 2011 were also his LPL advisory clients (Ex. 121), that four of the FC 2012 investors were his LPL advisory clients (Vernon "Ray" Branch, Timothy Goss, Leslie "Lee" Powell and Larry Price) (Ex. 123), and that he recommended the investments. (T. 756-762; Ex. 5, 54, 61, 121, 122, 123, 156). Furthermore, Ashley Shawn Hooks, another FC 2012 investor, testified during the hearing that she was also one of Respondent's LPL advisory clients (T. 1076).

Respondent also served as an investment adviser to the FC 2012 fund, advising it on which securities to purchase and how much, resulting in his trading of the fund's assets in exchange for the purchase of membership units in the real-estate equity offering by Piney Cumberland (Ex. 83, 87, 187). The subsequent misappropriation of investor funds by Respondent from the FC 2012 account served as his compensation for advising the FC 2012 fund and his individual clients. (T. 815, 912, 913, 1027, and Ex. 187). Judge Elliot, in his Initial Decision, correctly found that Respondent was "an investment advisor at all relevant times" in this matter. (I.D. 28-29). The Commission should also find Respondent to have been an investment advisor in this matter.

### ii. Respondent Defrauded His Advisory and Prospective Advisory Clients

Respondent violated the Advisers Act by misappropriating the assets of his client, the FC 2012 fund, which he advised on how to invest its funds. (T. 762; Ex. 81, 88, 90, 91, 187, 191). Instead of advising the fund to use all its assets to acquire membership units in Piney Cumberland Holdings, Respondent misappropriated $130,000 which had been provided by Brown, Carson and Malloy, collectively, for FC 2012 to use in the acquisition of Piney Cumberland membership units. (T. 815, 912, 912, and Ex. 88, 90, 91, 123, 187). As a result, Brown, Carson and Malloy – themselves prospective advisory clients – were defrauded, too. (T. 770-771; Ex. 88, 90, 91, 187, 191). Further, pursuant to his cover-up scheme attempting to conceal the misappropriation, Respondent also violated the prohibited transaction provisions of the Advisers Act by making misrepresentations and omissions of material fact to his four formal advisory clients and ten other prospective advisory clients participating in FC 2012 concerning, among other things, the amount each individual was investing and the size of each individual's *pro rata* ownership interest in FC 2012. (Ex. 53, 54, 61, 88, 90, 91, 123, 128, 187, 191). Respondent acted with the required scienter to establish a charge under Section 206(1). (T. 815-823, 912, 913, 921, 922).

Finally, Section 206(4) of the Advisers Act prohibits investment advisers from engaging in any "act, practice or course of business which is fraudulent, deceptive, or manipulative." Rule 206(4)-8(a)(1) defines as a fraudulent practice an investment adviser's making false statements of material fact to any investor or prospective investor in a pooled investment vehicle, or failing to state material facts necessary to make statements made to such investors not misleading. A "pooled investment vehicle" is defined as "any investment company as defined" by Section 3(a) of the Investment Company Act of 1940. Separately, Rule 206(4)-8(a)(2) further defines as a fraudulent practice an investment adviser's engaging in any act, practice, or course of business that

is fraudulent, deceptive or manipulative, with respect to any investor or prospective investor in the pooled investment vehicle. Scienter is not required to find a violation of this Rule. See Vernazza v. SEC, 327 F.3d 851, 859-60 (9th Cir. 2003); see also Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles, Release No. IA-2628, 2007 WL 2239114 at *5 & n.38 (August 3, 2007) ("We read the language of section 206(4) as not by its terms limited to knowing or deliberate conduct").

Here, Respondent and, through him, FC 2012, pooled investor money in the FC 2012 bank account in the name of, or for the benefit of, Lloyd's clients and himself personally, purportedly for the purpose of investing or trading in securities (ownership unit offerings). As such, FC 2012 meets the definition of an investment company under Section 3(a)(1)(A) of the Investment Company Act [15 U.S.C. § 80a-3(a)] which defines an investment company as including an issuer which "is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities." The primary purpose of FC 2012, as Respondent told his clients, was to pool investor funds in order to acquire ownership units in an entity that was expected to preserve land through a conservation easement, thereby generating profits through tax deductions which were larger than the individuals' initial investments. However, FC 2012 was not bound by its Operating Agreement to acquire units in Piney Cumberland or any other specific offering. (Ex. 90, 91, 191). Respondent advised the FC 2012 as to which securities to acquire and how much to acquire. (Ex. 90, 91, 191). Respondent's fraudulent misconduct as related to investors in FC 2012 – consisting of misappropriating investor funds, making false statements and omissions to investors about the use of their funds, and creating misstated Schedule K-1s – violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

## IV. APPROPRIATE SANCTIONS

### A. A Cease-and-Desist Order Is Warranted Given the Facts

In his Initial Decision, Judge Elliot properly issued a cease-and-desist order against Respondent. (I.D. 34). When determining whether to impose a cease-and-desist order, the Commission should consider a range of traditional factors, including:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); see also Richard C. Spangler, Inc., 46 S.E.C. 238, 254 n.67 (1976). No one criterion is dispositive.

Accordingly, based upon the evidence presented during the hearing, including Respondent's ever-changing explanations and his efforts to cover-up his scheme through an Amended Operating Agreement, and in light of the Steadman factors, above, all of which weigh heavily against Lloyd, the Commission should order that Lloyd cease and desist from committing or causing violations of or any future violations of Sections 206(4) of the Advisers Act. Further, based on the arguments above in this brief, the Commission should also order Lloyd to cease and desist from committing or causing violations of or any future violations of Section 17(a) of the Securities Act, Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act and Rule 206(4)-8 thereunder.

### B. Disgorgement Plus Prejudgment Interest Is Appropriate Because of Respondent's Ill-Gotten Gains

In his Initial Decision, Judge Elliot ordered Respondent to disgorge the $105,750 that Respondent claimed to have received in fees from clients participating in FC 2012. Judge Elliot

reasoned that but for Respondent's misrepresentations and omissions to SFA, he would not have been enriched by those fees. The Division now asks that the Commission hold Respondent liable for $197,280 in disgorgement, consisting of: (1) the $31,500 in fees that he made acting as an unregistered broker-dealer in the Forest Conservation 2011 offering; (2) the $35,780 in fees that he made from the FC 2012 II offering; and (3) the $130,000 that he misappropriated from his clients. Regarding prejudgment interest, Rule of Practice 600 specifies that it should begin on the first day of the month following each violation. 17 C.F.R. § 201.600. Under these facts, the Division suggests January 1, 2012 for the $31,500 in fees earned by Respondent for Forest Conservation 2011. Further, the Division suggests January 1, 2013 for the $130,000 misappropriated from clients in December 2012 and the $35,780 which Respondent earned in fees from FC 2012 II, also during December 2012.

### C. Civil Penalties Against Respondent Are in the Public Interest

In his Initial Decision, Judge Elliot ordered Respondent to pay $100,000 in civil penalties representing $50,000 for each of Respondent's two fraudulent misrepresentations to SFA. Six factors are relevant to determining whether civil monetary penalties are in the public interest: (1) deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) direct or indirect harm to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other matters as justice may require. See Section 203(i) of the Advisers Act. "Not all factors may be relevant in a given case, and the factors need not all carry equal weight." Robert G. Weeks, Admin. Proc. File No. 3-9952. Under the facts of this case, the Division requests that the Commission impose a civil penalty of $100,000 based on Respondent's violations of the federal securities laws, as outlined above. See SEC v. Kenton Capital, Ltd., 69 F. Supp. 2d 1, 17 n.15

(D.D.C. 1998) (imposing separate penalty for each of the 12 investors whom the defendant defrauded).

### D. An Associational Bar Against Respondent Is in the Public Interest

Judge Elliot ordered an associational bar against Respondent, finding that such a bar was in the public interest. The established criteria for determining whether a bar is in the public interest include:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); see also Richard C. Spangler, Inc., 46 S.E.C. 238, 254 n.67 (1976).

Here, Respondent acted with a high degree of scienter. His fraudulent conduct was planned, consistent, and recurrent. He has shown no remorse whatsoever. Instead, he took great efforts to conceal his fraud, fabricating a story that the misappropriated funds were fees to which he was entitled. Given his continuing lack of candor and that his current occupation could present him with opportunities for future unregistered broker-dealer and adviser violations, the Division recommends that the Commission order an associational bar against Respondent. See Montford and Company, Inc., et al., Advisers Act Release No. 3829, 2014 WL 1744130 (May 2, 2014) (associational bars imposed for failure to disclose conflict of interest).

## V. RESPONDENT'S APPEAL

Respondent's Opening Brief of November 9, 2015 includes an array of unfounded and ill-conceived arguments as to why the Initial Decision in this matter is flawed. Respondent's unpersuasive arguments fall into several broader categories and are addressed below.

## A. The Initial Decision Does Not Contain Erroneous Findings of Fact

### i. The Transactions Were Securities

Respondent's Opening Brief ("O.B.") argues at Sections IV(A)(1), (2), (9), (10) and (12) that portions of Judge Elliot's Initial Decision are factually erroneous because the transactions at issue were not securities. As explained above, the Division's offer of proof at the hearing showed that the transactions in this matter were securities because they were investment contracts. Further, regarding Respondent's specific arguments on this point, each contested portion of Judge Elliot's Initial Decision further fails to contain erroneous findings of fact because:

a. ***O.B. Section IV(A)(1) ("The finding that the membership units in Maple Equestrian, Piney Cumberland Holdings, and Meadow Creek Holdings LLC's were issued pursuant to Regulation D")***: The offering summaries for Maple Equestrian, Piney Cumberland and Meadow Creek Holdings each noted their respective reliance on exemptions under the federal securities laws in making the private placement offerings (Ex. 22, 55, 56) and Forms D were filed with the Commission for each. (Ex. 151, 152, 153);

b. ***O.B. Section IV(A)(2) ("The finding that Respondent's failure to inform LPL of the conservation easement transactions was inconsistent with LPL's compliance policies relating to selling away, outside business activities, and providing tax advice")***: LPL's Advisor Compliance Manual noted that associated persons, such as Respondent, were not supposed to sell away, were required to disclose outside business activities and were not supposed to provide clients with tax advice. (T. 307-318; Ex. 154 at Ch. 4,5, and Ex. 155 at Ch. 4, 5). Respondent testified that he did not disclose his Forest Conservation entities to LPL and that he provided tax advice to certain advisory clients. (T. 720 – 725, 764-765). Further, Respondent sold Forest Conservation entity interests to clients without telling LPL. (T. 720 – 725, 737, 764-765);

c. ***O.B. Section IV(A)(9) ("The finding that Respondent should not be able to avoid primary liability by selling away")***: Respondent admitted that he created the Forest Conservation entities and sold interests in these entities without informing LPL. (T. 720-725, 764-765); and

d. ***O.B. Sections IV(A)(10) ("The finding that Respondent's failure to inform SFA and PCH of the identities of the ultimate consumers undermined those entities' compliance efforts and created the potential for a conflict of interest") and IV(A)(12) ("The finding that Respondent created a risk that SFA and PCH would violate the securities laws")***: SFA representative Nancy Zak and her supervisor, Alex Sywak, testified that SFA and Piney Cumberland required that all participants in the Piney Cumberland offering, including sub-investors participating in an LLC, had to complete accredited investor paperwork in order to be vetted and approved for participation in the offering. (T. 104–108, 110-11, 537). This requirement was noted in the offering documents. (Ex. 22, 55, 56). Lloyd provided SFA with false information about his own investment amount and did not provide such finalized paperwork to SFA for Brown, Carson and Malloy, all of whom ultimately received tax deductions through Lloyd's cover up without having been vetted by SFA as accredited investors. (T. 184, 189, 194, 454, 814-815, 880-881, 924-925; Ex. 88, 90, 91, 123, 128, 191).

**ii. <u>Respondent Did Not Provide OCIE with the Revised Schedule I Listing Fifteen Members of FC 2012</u>**

***O.B. Section IV(A)(3) ("The finding that Respondent did not provide OCIE with the revised Schedule I listing 15 members of FC 2012, LLC")***: Respondent produced the FC 2012 revised Schedule I listing fifteen participants on April 5, 2013 in a production *to the Division of Enforcement* pursuant to an investigative subpoena. Respondent did not produce this list to the *National Exam Program* (OCIE) in his earlier productions, as far as the Division can tell.

### iii. The Summaries of Clients' Testimony Are Not Factually Erroneous

***O.B. Sections IV(A)(4) ("The finding that Ray Branch and Respondent's attorneys discussed Respondent's fees"), IV(A)(5) ("The finding that Respondent had the opportunity to influence Mark Losby's memory of his FC 2012 participation") and IV(A)(6) ("The finding that Respondent had the opportunity to influence Larry Price's memory of his FC 2012 participation"):*** Respondent admitted in his investigative testimony that he – in order to help his clients respond to the Division's document subpoenas – reminded his clients in the summer of 2013 about fees that he supposedly charged for them to participate in FC 2012, noting: "They don't remember those details." (T. 426 – 430, Ex. 144 at page 126). Respondent noted also that he never memorialized the alleged fees in writing at the time of the FC 2012 transactions and only first created any written record of fees once the National Exam Program asked him for documents. (T. 1007-1008). Many of his clients' production letters to the Division in response to document subpoenas have similar, almost identical, language concerning the fees they were supposedly charged. (Ex. 130 – 143, 168-169). Respondent admitted in his investigative testimony that he told his clients about their fee amounts after they received their subpoenas. (Ex. 144 at p. 127). Further, Respondent's clients also communicated with Respondent's counsel regarding the details of their investment in FC 2012 before the clients testified at the hearing, including Mr. Branch who testified that he discussed the topic of fees with Respondent's counsel. (T. 1110-1103, 1068-1070).

### iv. Non-Factual Statements from the Initial Decision Are Not Factually Erroneous

***O.B. Sections IV(A)(7) ("The finding that Respondent may have stolen $130,000.00 from his clients outright had he not been examined by LPL and OCIE") and IV(A)(8) ("The finding that Respondent possessed independent contractor-like autonomy while associated with LPL making him more like a controlling person of an investment advisory rather than an employee***

***of same")*:** As Judge Elliot noted in his Order of August 18, 2015 in response to Respondent's Motion to Correct Manifest Errors of Fact, the sentences noted in Sections IV (A)(7) and (8) of Respondent's Opening Brief are not part of his findings of fact, and, therefore, cannot be manifestly erroneous. However, the Division contends, as explained above, that the evidence from the hearing shows that Respondent did misappropriate $130,000 from his clients and Respondent, who was acting as an unregistered investment advisor here, did have independent contractor-like autonomy over his LPL branch office.

v. **But for Respondent's Deceit of SFA, No Clients Would Have Participated in FC 2012**

***O.B. Section IV(A)(11) ("The finding that but for his deceit of SFA, none of Respondent's clients could have participated in FC 2012, and he would not have been entitled to any of his fees")*:** Piney Cumberland attorney Peter Hardin testified that if it had been discovered that FC 2012's accredited investor paperwork was false concerning the sub-investors and their amounts of investment, then Piney Cumberland "would have not permitted FC 2012 to have invested." (T. 469). Respondent intentionally and knowingly told SFA that Carson was "OUT" of FC 2012, despite knowing that Carson had given money to invest in FC 2012 and his money was already in the FC 2012 bank account. (T. 806-807, 815). Respondent intentionally and knowingly told SFA that he was investing $41,052 when he actually only put in $16,802 to the FC 2012 bank account. (T. 1020 - 1029). Without Respondent's deceit of SFA as to the identity of the investors and the amount each was investing, he would have never been able to close the transaction and misappropriate the funds that he claimed as fees. His subsequent efforts to cover up his scheme do not erase his intentional misdeeds.

## B. The Initial Decision Does Not Contain Erroneous Conclusions of Law as Claimed by Respondent in His Opening Brief

As noted above in this brief, Judge Elliot properly found that Respondent was acting as an investment advisor in relation to these transactions and, as such, he violated Section 206(4) of the Advisers Act. As explained herein, the erroneous conclusions of law by Judge Elliot were in his not finding that Respondent also violated Advisers Act Sections 206(1), 206(2) and 206(4) through his defrauding of his advisory and prospective advisory clients.

## C. The ALJ Did Not Lack Authority to Conduct the Hearing

Respondent contends that this proceeding violates the Advisers Act because the ALJ who presided over the hearing lacked statutory authority to do so. Respondent cites Section 212 of the Act, which states that administrative hearings may be held before "any officer or officers of the Commission," 15 U.S.C. § 80b-12, and he notes that in its recent opinion in Timbervest, LLC, Investment Advisers Act Release No. 4197, 2015 WL 5472520, at *23-26 (Sept. 17, 2015), the Commission held that its ALJs are employees, not constitutional officers. Thus, Respondent argues, the Commission erred in allowing a mere employee to preside over his hearing.

Respondent fails to acknowledge, however, that in Timbervest, 2015 WL 5472520, at *26 n.165—as well as in Raymond J. Lucia Cos., Exchange Act Release No. 75837, 2015 WL 5172953, at *23 n.122 (Sept. 3, 2015), and David F. Bandimere, Exchange Act Release No. 76308, 2015 WL 6575665, at *21 n.127 (Oct. 29, 2015)—the Commission squarely rejected the very argument he makes here. In those opinions, after concluding that its ALJs were not officers for purposes of Article II of the Constitution, the Commission explained that there is no "relevance in the fact that the federal securities laws and our regulations at times refer to ALJs as 'officers' or 'hearing officers.'" Bandimere, 2015 WL 6575665, at *21 n.127. This is because there is "no indication that Congress intended" the statutory term "officers," or "hearing officers," as used in

the securities laws, "to be synonymous with 'Officers of the United States,'" as used in Article II. Id. Moreover, the Commission noted, "the Administrative Procedure Act 'consistently uses the term officer or the term officer, employee, or agent' to 'refer to [agency] staff members.'" Id. (quoting Kenneth Culp Davis, Separation of Functions in Administrative Agencies, 61 Harv. L. Rev. 612, 615 & n.11 (1948)). Thus, the Commission held, the securities laws do not require that administrative hearings be presided over by constitutional "officers." Id.

Respondent offers no reason why the Commission's sound conclusion should be reconsidered. Accordingly, for the same reasons the Commission has previously articulated, Respondent's claim that the presiding ALJ lacked statutory authority to conduct the hearing fails.

**D. Respondent Has Not Been Denied Due Process**

Respondent suggests that the administrative proceeding denies him due process because the hearing was not conducted under the Federal Rules of Evidence and the Federal Rules of Civil Procedure. But it is well settled that the Federal Rules do not apply in the Commission's administrative proceedings, Ralph Calabro, Securities Act Release No. 9798, 2015 WL 3439152, at *10 & n.66 (May 29, 2015), and any claim that this fact renders an administrative proceeding unfair has been consistently rejected by the courts. See, e.g., Cunanan v. INS, 856 F.2d 1373, 1374 (2d Cir. 1988). Moreover, Respondent fails to show how the application of the Commission's Rules of Practice caused the type of prejudice necessary to establish a due process violation. See, e.g., Horning v. SEC, 570 F.3d 337, 347 (D.C. Cir. 2009) ("In the absence of any suggestion of prejudice, we cannot conclude that Horning was deprived ... of procedural due process."). Thus, he cannot demonstrate that he has been denied due process simply because the Federal Rules of Evidence and the Federal Rules of Civil Procedure do not apply.

To the extent Respondent's complaint is, more broadly, that the administrative process is somehow procedurally deficient—and, thus, it violates due process to require him to proceed in an administrative forum—that, too, fails. As the Commission recently observed, "[s]uch broad attacks on the procedures of the administrative process have been repeatedly rejected by the courts." Harding Advisory LLC, Securities Act Release No 9561, 2014 WL 988532, at *8 (Mar. 14, 2014). Indeed, courts have correctly recognized that to accept such challenges "would do considerable violence to Congress['s] purposes in establishing" specialized administrative agencies and would "work a revolution in administrative (not to mention constitutional) law." Blinder, Robinson & Co. v. SEC, 837 F.2d 1099, 1107 (D.C. Cir. 1988). Due process requires only "the opportunity to be heard 'at a meaningful time and in a meaningful manner,'" Mathews v. Eldridge, 424 U.S. 319, 333 (1976), and here Respondent has been afforded such opportunity.

**E. Respondent's Bias Allegations**

It is well established that adjudicators—including ALJs—are presumed to be unbiased. *See* Schweiker v. McClure, 456 U.S. 188, 195 (1982); Withrow v. Larkin, 421 U.S. 35, 47 (1975) (applying "a presumption of honesty and integrity in those serving as [agency] adjudicators"); FTC v. Cement Institute, 333 U.S. 683, 701 (1948). This presumption creates a heavy burden for those seeking to establish bias: they must make "a showing of conflict of interest or some other specific reason for disqualification." Schweiker, 456 U.S. at 195-96; see also SEC v. First City Fin. Corp., 890 F.2d 1215, 1222 (D.C. Cir. 1989) (allegations of bias must show that the "judge's mind was 'irrevocably closed' on the issue"). They must demonstrate, for example, "that the ALJ's behavior, in the context of the whole case, was 'so extreme as to display clear inability to render fair judgment.'" Rollins v. Massanari, 261 F.3d 853, 858 (9th Cir. 2001) (quoting Liteky v. United States, 510 U.S. 540, 551 (1994)).

Here, in support of his bias claim, Respondent cites certain evidentiary rulings, as well as statements by Judge Elliot suggesting disagreement with rulings made by the previously assigned ALJ. Although it is always a judge's own prerogative to assess his or her own impartiality, we note that, as a legal matter, the ALJ's prior decisions, alone, do not establish bias. See Liteky, 510 U.S. at 555 ("[J]udicial rulings alone almost never constitute a valid basis for a bias or partiality motion." (citations omitted)); accord Marcus v. Dir., Office of Workers' Compensation Programs, 548 F.2d 1044, 1051 (D.C. Cir. 1976) ("The mere fact that a decision was reached contrary to a particular party's interest cannot justify a claim of bias, no matter how tenaciously the loser gropes for ways to reverse his misfortune."). And, as Judge Elliot himself pointed out, he made evidentiary determinations that benefited *both* the Division *and* Respondent. ( I.D. 32).

Nevertheless, as the Division has previously explained (see Response to Respondent's Motion for Leave to Adduce Additional Evidence), the established procedure to resolve allegations of bias by the presiding ALJ is a motion for recusal under Rule of Practice 111(f). See 17 C.F.R. § 201.111(f); United States v. Torkington, 874 F.2d 1441, 1446 (11th Cir. 1989). And although Judge Elliot addressed Respondent's bias claim, and found Respondent's evidence of bias lacking (I.D. 32), Respondent has never formally requested that Judge Elliot recuse himself from the proceedings. Accordingly, should Respondent so choose, he may move the Commission for a limited remand to allow him to submit a recusal motion to Judge Elliot.

## VI. CONCLUSION

For the foregoing reasons, and based upon the evidence presented by the Division at the hearing, the Commission should find that Respondent violated the federal securities laws as explained herein, and as set forth in the Order Instituting Administrative and Cease-and-Desist Proceedings, and grant relief as requested herein.

This 10th day of December 2015.

Respectfully submitted,

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

## CERTIFICATE OF COMPLIANCE

The undersigned counsel for the Division of Enforcement hereby certifies, in compliance with the requirements of Rule of Practice 450(c) of the Securities and Exchange Commission, that the word count for the **DIVISION OF ENFORCEMENT'S PRINCIPAL AND RESPONSE BRIEF** filed with the Commission on December 10, 2015 contains a total of 13,318 words, exclusive of the table of contents, table of authorities and certificates of compliance and service, as reported by the word processing program used to prepare the Division's brief.

This 10th day of December 2015.

Respectfully submitted,

Brian M. Basinger
Counsel, Division of Enforcement
Securities and Exchange Commission
950 E. Paces Ferry Road NE, Suite 900
Atlanta, Georgia 30326-1232
(404) 842-5748
basingerb@sec.gov

## CERTIFICATE OF SERVICE

The undersigned counsel for the Division of Enforcement hereby certifies that he has served the **DIVISION OF ENFORCEMENT'S PRINCIPAL AND RESPONSE BRIEF** to the individuals identified below as follows:

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

Frederick K. Sharpless, Esq. (***via email and UPS***)
Stavola & Sharpless, P.A.
200 South Elm Street, Suite 400
Greensboro, NC 27401

Alex Rue (***via email and UPS***)
AlexRueLaw LLC
4060 Peachtree Rd.
Suite D511
Atlanta, GA 30319

William Woodward Webb, Jr. (***via email and UPS***)
The Edmisten, Webb & Hawes Law Firm
127 West Hargett Street, Suite 104
Raleigh, North Carolina 27601

Dated: December 10, 2015

Brian M. Basinger
Counsel, Division of Enforcement
Securities and Exchange Commission
950 E. Paces Ferry Road NE, Suite 900
Atlanta, Georgia 30326-1232
(404) 842-5748
basingerb@sec.gov