HARD COPY

RECEIVED
NOV 01 2016
OFFICE OF THE SECRETARY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16594

In the Matter of

EQUITY TRUST COMPANY,

Respondent.

DIVISION OF ENFORCEMENT'S REPLY IN SUPPORT OF ITS PETITION FOR REVIEW AND OPPOSITION TO RESPONDENT'S CROSS-PETITION

DIVISION OF ENFORCEMENT
David Stoelting (212.336.0174)
Andrew Dean (212.336.1314)
Securities and Exchange Commission
200 Vesey Street, Suite 400
New York, NY 10281-1022
212.336.1323 (fax)

October 31, 2016

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

PRELIMINARY STATEMENT 1

ARGUMENT 3

I. EQUITY TRUST KNEW OR SHOULD HAVE KNOWN THAT ITS CONDUCT WOULD CONTRIBUTE TO THE PRIMARY VIOLATIONS 3

A. Equity Trust Does Not Dispute Its Actual Knowledge of the Primary Violations 3

B. Equity Trust's Unreasonable and Negligent Conduct Proves that It "Should Have Known" that Its Conduct Would Contribute to the Primary Violations 4

1. Equity Trust Acted Unreasonably by Endorsing and Recommending Taylor and Poulson Without Conducting Due Diligence 4

2. Equity Trust Acted Unreasonably By Failing to Take Custody of Its Customers' Assets 6

3. Equity Trust Acted Unreasonably by Failing to Respond to Red Flags 9

C. Equity Trust's Representations of Fact in Support of Its Lack of Negligence Are Irrelevant, Misleading, and Unsupported by the Evidence 9

1. Equity Trust Had Close Relationships with, and Endorsed, Sponsored, and Recommended, Taylor and Poulson 10

a. Taylor 10

b. Poulson 12

2. Taylor's and Poulson's "Public Profiles" Are Irrelevant 14

D. Equity Trust's Flawed and Misleading Arguments Regarding the Expert Witnesses. 15

II. EQUITY TRUST'S CROSS-PETITION FOR REVIEW IS WITHOUT MERIT 17

A. The ALJ Correctly Found that "Acts and Omissions" by Equity Trust Were a Cause of the Violations 17

B. Evidence of Equity Trust's Negligence Is Sufficient Because the Primary Violations Are Non-Scienter 19

C. The Evidence Proves the Primary Violations 20

D. Equity Trust's Constitutional Arguments Are Without Merit 24

III. SIGNIFICANT REMEDIES SHOULD BE IMPOSED 26

A. Disgorgement and Prejudgment Interest Are Appropriate 26

B. A Significant Civil Penalty Is Appropriate 28

C. Cease-and-Desist Order and Compliance Consultant Are Appropriate 30

CONCLUSION 31

TABLE OF AUTHORITIES

Cases

Adelson v. Hananel, 652 F.3d 75 (1st Cir. 2011) 10
Alfred Miller, Rel. No. 233, 1966 WL 84130 (Dec. 28, 1966) (Comm'n Op) 10
Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n, 430 U.S. 442 (1977) 25
Bentley v. Equity Trust Co., 2015 WL 7254796 (Ct.App.Ohio Nov. 16, 2015) 6
Daniel Bogar, Rel. No. 502, 2013 WL 3963608, (Init. Dec. Aug. 2, 2013) 20, 26
Deal v. Asset Management Group, 92 Civ. 187, 1992 WL 212482 (Aug. 28, 1992) 23
Erik W. Chan, Sec. Rel. No. 8078, 2002 WL 507022 (Apr. 4, 2002) (Comm'n Op.) 14
George J. Kolar, SEC Release No. 152, 1999 WL 977373 (Oct. 28, 1999) 24
Harding Advisory LLC, Securities Act Release No 9561, 2014 WL 988532 (Mar. 14, 2014) 25
Harrison Securities, Inc., Rel. No. 256, 2004 WL 2109230 (Init. Dec. Sept. 21, 2004) (Finality Order Oct. 29, 2004) 19
Hines v. Fiserv, Inc. 2010 WL 1249838 (M.D. Fla. Mar. 25, 2010) 6
J.S. Oliver Capital Management, L.P., Rel. No. 10100, 2016 WL 3361166 (June 17, 2016) (Comm'n Op.) 28, 29, 30
Jarkesy v. SEC, 805 F.3d 9 (D.C. Cir. 2015) 25
John Thomas Capital Mgmt. Group LLC, Rel. No. 693, 2014 WL 5304908 (Init. Dec. Oct. 17, 2014) , *rev. granted*, Rel. No. 3978, 2014 WL 6985130 (Dec. 11, 2014) 26
KPMG Peat Marwick LLP, Rel. No. 1360, 2001 WL 47245 (Jan. 19, 2001), *aff'd*, 289 F.3d 109 (D.C. Cir. 2002) 18, 20, 30
Mandelbaum v. Fiserv, Inc., 787 F Supp.2d 1226 (D. Colo. 2011) 5, 6
McClelland v. Andrus, 606 F.2d 1278 (D.C. Cir. 1979) 25
Mercer v. Jaffe, Snider, Raitt and Heuer, P.C., 736 F. Supp. 764 (W.D. Mich. 1990) 24
Meza v. Colvin, 2015 WL 5773751 (D. Colo. Sept. 30, 2015) 15, 17
Mid-Ohio Securities Corp. v. Estate of Burns, 790 F. Supp.2d 1263 (D. Nev. 2011) 6
Raymond J. Lucia Cos., Inc., et al., Rel. No. 4190, 2015 WL 5172953 (Sept. 3, 2015), *aff'd*, *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 2016 WL 4191191 (D.C. Cir. Aug. 9, 2016) .. 24
Reves v. Ernst & Young, 494 U.S. 56 (1990) 22
Rita J. McConville, Rel. No. 2271, 2005 WL 1560276 (June 30, 2005) (Comm'n Op.), *pet. denied*, 465 F.3d 780 (7th Cir. 2006) 19
Scott M. Stephan, Rel. No. 888, 2015 WL 5637557 (Sept. 25, 2015) 26
SEC v. Brooks, 99 Civ. 1326, 1999 WL 493052 (N.D. Texas 1999) 22
SEC v. Citigroup Global Markets, Inc., 752 F.3d 285 (2d Cir. 2014) 25
SEC v. Murphy, 626 F.2d 633 (9th Cir. 1980) 22
Skydive Ariz., Inc. v. Quattrocchi, 673 F.3d 1105 (9th Cir. 2012) 15
Timbervest, LLC, et al., Rel. No. 4197, 2015 WL 5472520 (Sept. 17, 2015) 24
Tull v. United States, 481 U.S. 412 (1987) 25
Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519 (1978) 25

Statutes

15 U.S.C. § 77h-1(a) 18, 30
Section 17(a) of the Securities Act of 1933 .... 20, 21, 30

The Division of Enforcement respectfully submits this Reply and Opposition Brief in response to Equity Trust Company's opening brief dated October 17, 2016 ("Resp. Br.").[1]

PRELIMINARY STATEMENT

Seeking to create an alternate reality, Equity Trust denies that it ever endorsed or promoted investments and issuers, denies that it failed to obtain critical security documentation, and denies any unreasonable conduct at all. The evidence, however, contradicts Equity Trust's denials. Even the ALJ, whose decision Equity Trust seeks to affirm, found that Equity Trust "facilitated the receipt and retention of investor funds by the fraudsters," made a "recommendation to invest" in Ephren Taylor's fraud, and tolerated "sloppy record keeping" and "missing documentation."

The linchpin of Equity Trust's alternate reality is the assertion that Equity Trust merely had "limited contact" with Ephren Taylor and Randy Poulson, the two fraudsters who directed dozens of customers to Equity Trust. In fact, Equity Trust's sales and marketing representatives spent years fostering relationships with Taylor and Poulson through outright endorsements, cross-sponsorships, trainings, webinars, speaking engagements, attendance at each other's events, and the unrestrained transfer of private customer information to Taylor and Poulson to speed up delivery of funds to the fraudsters. All of this was done to increase account-opening fees through coveted "centers of influence" like Taylor and Poulson. As a result, Equity Trust lost sight of its limited role as a passive custodian of retirement funds.

---

[1] In this brief, "DE" means Division Exhibit; "RE" means Respondent's Exhibit; and "Tr." means the transcript of the eight-day hearing held in December 2015.

Equity Trust's failures as an IRA custodian were demonstrated at the hearing. And the ALJ dismissed the case not because she found Equity Trust's conduct to be exemplary, but rather because she applied the wrong legal test. As the Division's opening brief ("Division's Brief") demonstrated, the ALJ erred by requiring proof that Equity Trust had actual knowledge of the fraud. In causing cases, however, when the primary violations are nonscienter, only evidence of negligent conduct is required to prove the violation. The ALJ compounded the error by evaluating Equity Trust's conduct as if it were a passive custodian. In fact, far from being passive, Equity Trust negligently endorsed, sponsored, and recommended Taylor and Poulson without conducting due diligence or taking other reasonable steps, such as following up on numerous red flags. Once Equity Trust elected, on its own initiative, to engage in these activities in an unreasonable manner, and by processing Taylor and Poulson investments without reasonable care, it exposed its customers to increased risk and contributed to the primary violations.

Given the ALJ's correct findings that the primary violations were proven, and that Equity Trust's acts and omission were a cause of these violations, then once the correct legal test is applied a reversal of the Initial Decision ("ID") is warranted.

Equity Trust has custody of more than $10 billion in retirement funds from investors nationwide and has engaged in violative conduct that has helped wipe out the retirement funds of approximately 100 individuals – including a truck driver, a real estate broker, an unemployed former school teacher and nurse, a retired aviation analyst, and two engineers, all of whom testified – who invested with Taylor and Poulson. Equity Trust's conduct warrants a cease-and-desist order, disgorgement of account fees plus prejudgment interest, a stringent monetary penalty, and the appointment of a compliance consultant.

ARGUMENT

I. EQUITY TRUST KNEW OR SHOULD HAVE KNOWN THAT ITS CONDUCT WOULD CONTRIBUTE TO THE PRIMARY VIOLATIONS

The evidence proves that Equity Trust both "knew" ***and*** "should have known" that its conduct contributed to the primary violations. Either provides a basis for finding that the third causing element was proven and reversing the Initial Decision.

A. Equity Trust Does Not Dispute Its Actual Knowledge of the Primary Violations

Equity Trust's brief fails to contradict the Division's argument that it had actual knowledge of two of the primary violations: Taylor's and Poulson's marketing and sale of unsecured notes as secured, and Taylor's false statements to an audience of thousands at the New Birth Church event.

As the ALJ held, the primary violations involved "proven misconduct" by Taylor and Poulson that included the operation of "a course of business that operated as a fraud on the purchasers of [their] notes." ID at 31. A central part of their misconduct was the sale of supposedly secured notes to investors that were, in fact, unsecured. Div. Br. 33-34, 36. Equity Trust knew that the investors believed that their notes were secured because this is what the customers' Direction of Investment forms showed. DE 40 at 5-6, 9-19; Tr. 699-700 (Dea). Equity Trust, therefore, should have received a security agreement (for the Taylor Notes) or a recorded mortgage (for the Poulson Notes) in order to carry out its customers' investment intent. Div. Br. 20-22, 30-31. Equity Trust knew that it did not receive the required documentation and nevertheless transferred customer funds to Taylor and Poulson. Div. Br. 33-36.

Equity Trust also knew that Taylor materially misrepresented Equity Trust's role at New Birth Church in front of thousands of potential investors.[2] Tr. 404-405, 408; Answer ¶ 39. And as Equity Trust knew, the purpose of Taylor's remarks at New Birth Church was to market and sell Taylor Notes to investors.[3] Taylor's misrepresentations about Equity Trust and Robert Batt were at least negligent and part of a "course of business that operated as a fraud." Div. Br. 33-36.

Because Equity Trust knew that its conduct would contribute to these primary violations, reversal of the Initial Decision is warranted.

B. Equity Trust's Unreasonable and Negligent Conduct Proves that It "Should Have Known" that Its Conduct Would Contribute to the Primary Violations

As a result of Equity Trust's negligent conduct, Equity Trust "should have known" that its actions would contribute to the nonscienter primary violations. Div. Br. 37-38.

1. Equity Trust Acted Unreasonably by Endorsing and Recommending Taylor and Poulson Without Conducting Due Diligence

Equity Trust fails to address the most critical issue in evaluating Equity Trust's negligence: whether Equity Trust acted unreasonably by endorsing, sponsoring, and recommending Taylor and Poulson without conducting any due diligence. And Equity Trust

---

[2] As he admitted at the hearing, Batt knew that Taylor's statements were false; nevertheless, Batt never corrected the misrepresentations, either during his many conversations with investors at New Birth Church or afterwards. Tr. 405-411. Batt's supervisors, who learned of the misrepresentations from Batt, also did nothing. Tr. 412-414.

[3] Equity Trust's claim that "Taylor did not market City Capital notes" at New Birth Church is wrong. Resp. Br. 13. The ***only*** purpose of Taylor's Wealth Tour, which included his remarks at New Birth Church, was to sell promissory notes and generate desperately needed revenue for City Capital, which was why City Capital personnel were waiting in the lobby to sign up investors. DE 36 at 23 (86) (Taylor: City Capital raised "a couple of million dollars" from the event). Equity Trust knew that Taylor would be promoting his promissory notes during the event. DE 25.

does not dispute that a custodian that endorses, sponsors, and recommends issuers should be required to conduct due diligence or inform investors of any issues.[4]

Instead, Equity Trust argues that determining whether a custodian is passive is "unworkable" because of the difficulty in deciding "how 'un-passive' a custodian would have to be to void contractual provisions" that purportedly limit its duties to customers.[5] Resp. Br. 8.

Under this record, however, distinguishing a passive custodian from an "un-passive" one is not difficult. Equity Trust's endorsement, promotion, and recommendation of Taylor and Poulson plainly crossed the line.[6] Div. Br. 41-45. As some of the more egregious examples, Equity Trust sales representatives attended Taylor's and Poulson's solicitation events, recommended them in "glowing" terms, helped "close" deals for them, and illegally provided confidential customer information to them. The sales representatives' partnerships with the issuers are best captured by Batt's numerous emails to Taylor: "Let's make money together!" DE 27, 15, 23.

Rather than defend the reasonableness of its actions, Equity Trust reverts to its fallback argument: the customer agreements shield it from any liability, citing to *Mandelbaum v. Fiserv, Inc.*, 787 F Supp.2d 1226 (D. Colo. 2011), and *Hines v. Fiserv, Inc.* 2010 WL 1249838 (M.D.

[4] Equity Trust's brief repeats the ALJ's mistake of considering the Investor Alert issued by the staff of the SEC's Office of Investor Education and Advocacy in 2011 a "statement of the Commission's" when, in fact, it is a statement of the staff and specifically states that it is "neither a legal interpretation nor a statement of SEC policy." RE 46 at 5.

[5] Equity Trust claims that the Division "does not cite a single case, statute, regulation or other authority, much less a securities case, for this proposition." Resp. Br. 8. In fact, the Division cited to seven cases, all of them securities cases, to support its argument, which Equity Trust fails to address. Div. Br. 44-45.

[6] No evidence exists that other IRA custodians attended issuer events or engaged in the type of promotional activity that Equity Trust did. *See* DE 36 at 80 (309) (even though City Capital had used four other IRA custodians, only Equity Trust attended a Taylor event); Tr. 283 (Marsh: two IRA custodians he worked for after leaving Equity Trust did ***not*** attend issuer events); Div. Br. 28 (Equity Trust only custodian to sponsor Poulson's dinner series).

Fla. Mar. 25, 2010). In these cases, however, there was no allegation that the IRA custodian recommended or promoted the investment. *See Mandelbaum,* 787 F. Supp.2d at 1236 (complaint contains only "general and vague allegations"); *Hines*, 2010 WL 1249838, at *5 (IRA custodian not alleged to have recommended investment). Equity Trust, moreover, ignores the *Bentley* and *Burns* decisions cited in Division's Brief. In *Bentley*, the Ohio Court of Appeals rejected Equity Trust's argument that the "broad exculpatory clauses" in customer agreements preclude its customers' tort claims. *Bentley v. Equity Trust Co.*, 2015 WL 7254796, at *3 (Ct.App.Ohio Nov. 16, 2015). And in *Burns*, the District Court affirmed a $290,000 arbitral award that arose from allegations that Mid-Ohio ignored "red flags" and "was required to perform basic due diligence...[and] failed to do so." *Mid-Ohio Securities Corp. v. Estate of Burns*, 790 F. Supp.2d 1263, 1265 (D. Nev. 2011).[7]

2. Equity Trust Acted Unreasonably By Failing to Take Custody of Its Customers' Assets

Equity Trust cannot dispute that, as an IRA custodian, it had a duty to obtain security agreements for the supposedly "secured" Taylor Notes and failed to do so. Equity Trust's compliance director stated in an email that "we SHOULD have asked for [the security]...I am very concerned that we did not ask for collateral on the prior note seeing that the client stated it secured." DE 374 at 1. Similarly, Equity Trust knew at least by June 2010 that all 25 Poulson Notes had "inadequate documentation," meaning that the recorded mortgages that were supposed to secure the Poulson Notes were not obtained. DE 256 at 3. Michael Dea, Equity Trust's president, confirmed that, unless the applicable security agreement is obtained, Equity Trust has

[7] The ALJ found that *Burns* was decided on "procedural grounds" and therefore "does not support the Division's position." ID at 36. This misses the significance of *Burns*: if the customer agreements provided the immunity that Equity Trust claims, then the arbitral panel would not have ruled in the customer's favor and the District Court would not have denied Mid-Ohio's motion to vacate.

not fulfilled its duties to obtain the asset. Tr. 699-700. Equity Trust's own internal procedures required it to hold and maintain "applicable documents pertaining to the client investment" and "review the documents for completeness." DE 53 at 3. This includes "a UCC filing to Evidence Security or Title to the Collateral with Lien Attached," or a "Executed Deed of Trust/Mortgage." DE 53 at 3, 11-13. Equity Trust's South Dakota regulator, Scott Kelly, confirmed that Equity Trust must obtain all account documentation. Tr. 1191.

In a blame-the-customer argument, Equity Trust insists that if documents were missing, it was the customer's fault because Equity Trust could not "chase after investment documents." Resp. Br. 7. Customers, however, had no way of knowing that Equity Trust transferred funds out of retirement accounts to issuers even when security documents were missing. All of its customer communications stated or implied that documents relating to an investment, including mortgage deeds, would be gathered ***before*** funds were transferred from the custodial account. DE 790 at 2; 801 at 27; 764 at 8; 856 at 8. Neither the DOI nor the custodial agreement told customers that Equity Trust would release retirement funds from the custodial account even though it knew that critical documentation was missing.[8] Equity Trust did this 35 times with the Taylor customers and 38 times with the Poulson customers. DE 40 at 5-6; DE 41 at 3.

Equity Trust's focus should have been ensuring receipt of documents evidencing the customers' investment intent. Instead, Equity Trust's priority was rapidly moving funds from

[8] Equity Trust quotes an excerpt from the custodial agreement that it claims informed customers that "it was their obligation to obtain the documentation and furnish it to ETC." Resp. Br. 7. This provision merely states that Equity Trust could rely on documents that it received. It did not tell customers that Equity Trust transferred retirement funds to issuers even though it knew that crucial security documents were missing. And regardless of whose responsibility it was to provide the documents, Equity Trust should not have transferred funds to Taylor and Poulson when there were missing documents. As Michael Dea testified, if the DOI shows a secured investment and a security agreement is missing, then Equity Trust has not taken custody of the asset. Tr. 699-700. In those circumstances, Equity Trust has failed to fulfill the duty in the DOI "to hold Retirement Account assets." DE 40 at 39 (¶ 5).

custodial accounts to issuers. In dozens of emails, Batt kept City Capital apprised of the status of customer transfers, commenting "good to go" and "fully funded now," which were signals to Taylor that he should submit the DOI so that the funds could be transferred from the custodial account to Taylor's control. Div. Br. 20. *See also* Div. Br. 31 (emails re Poulson transfers).

Equity Trust touts its "onboarding" letter and quarterly account statements as evidence that customers were told that Equity Trust was "awaiting receipt" of certain documents. Resp. Br. 7. The critical fact, however, which Equity Trust fails to mention, is that the onboarding letter was ***the first time*** that Equity Trust ever told customers that it was the customer's responsibility to track down documents. And account statements, which came weeks or months after the initial transfer, were the first time customers learned which documents were actually missing. By the time the customer received an onboarding letter and account statements, the retirement funds had been transferred out of the custodial account and into the hands of Taylor or Poulson.

Glenn Savary, a Poulson victim, testified that he was shocked when he learned that Equity Trust had transferred his retirement funds from the custodial account to Poulson even though Equity Trust had not received a recorded mortgage:

> What was the rush to get this out the door? And plus the promissory note and mortgage wasn't in place. How can one do that in good conscience? I don't understand that. At that time, we put blind trust into [Equity Trust] to take care of this hard earned money and now, you get screwed over.

Tr. 1084.

The answer to Savary's question about Equity Trust's haste to transfer funds from the custodial account to issuers – "What was the rush to get this out the door?" – is obvious: issuers and promoters like Taylor and Poulson were the priority because they generated account opening referrals and fees.

3. Equity Trust Acted Unreasonably by Failing to Respond to Red Flags

Equity Trust either does not address or minimizes red flags. Div. Br. 46-47. For example, Equity Trust does not mention that Edwin Kelly, a senior officer at Equity Trust, learned in 2008 that Ephren Taylor was accused of being a "crook," which caused Kelly not to conduct a marketing webinar with Taylor. Tr. 598-605. While Equity Trust discusses the events at New Birth Church, it fails to address the significance of Taylor's false statements, which were a major red flag. Equity Trust barely acknowledges the fact that Taylor falsely represented notes as secured when they were unsecured. Equity Trust also does not address the significance of Equity Trust's knowledge in June 2010 that Equity Trust did not have a single recorded mortgage supporting any of Poulson's promissory notes. Jeffrey Bartlett, a former Equity Trust compliance officer, described this lack of documentation as "a red flag." Tr. 907-908.[9] And Equity Trust's policies required it to discontinue processing investments when there was missing documentation. Equity Trust also ignores the fact that Equity Trust continued to process replacement notes for Taylor and Poulson after they were placed on the Do Not Process list.

C. Equity Trust's Representations of Fact in Support of Its Lack of Negligence Are Irrelevant, Misleading, and Unsupported by the Evidence

Equity Trust makes two other factual arguments: (1) Equity Trust did not have close relationships with Taylor and Poulson; and (2) individuals invested with Taylor and Poulson

[9] Bartlett, in his investigative testimony, in response to the question, "[w]hy is missing documentation an issue?" stated that "we consider that a red flag that, you know, there may be some problems with that investment because they are obviously not providing the documents that are required...that's when we try to get them all in, otherwise we cease doing business with them." Tr. 907-908.

solely because of their public profile. Resp. Br. 8-19. These arguments are either unsupported by the evidence or irrelevant.[10]

1. Equity Trust Had Close Relationships with, and Endorsed, Sponsored, and Recommended, Taylor and Poulson

a. Taylor

Equity Trust, despite partnering with Taylor from early 2008 through the end of 2009, now argues that it had "limited interaction" with Taylor and City Capital. Resp. Br. 11. This revisionist history is belied by the evidence of an active sales and marketing relationship between Equity Trust and Taylor. For example, Equity Trust and Batt saw Taylor as an important referral source. DE 23 (Batt email thanking Taylor for making Batt the "#1" sales representative "last month"). As a result, Batt conducted an in-person training and webinar with Equity Trust personnel on how self-directed IRAs could be part of their solicitations, attended City Capital's solicitation event at New Birth Church, sent City Capital confidential customer information,[11] helped "close" deals, and made glowing remarks about Taylor. Div. Br. 41.

---

[10] Equity Trust argues that it is entitled to "an inference" that the investors who did not testify at the hearing – and who Equity Trust did not subpoena – would have been "weak[]" witnesses for the Division. Resp. Br. 21, 26. The Commission has previously rejected this argument. *Alfred Miller*, Rel. No. 233, 1966 WL 84130, at *5 (Dec. 28, 1966) (Comm'n Op) ("there is no basis for an inference that [respondent's] customers who were not called as witnesses would have testified adversely to the Division's position. In any event, [respondent] was free to call them."). *See also Adelson v. Hananel*, 652 F.3d 75, 80 (1st Cir. 2011) (denying adverse inference when party requesting the inference failed to subpoena witness).

[11] Equity Trust's only source for its claim that Batt "obtained PIN numbers before providing information" to City Capital is Batt's unreliable testimony. None of the many emails between Batt and City Capital refer to PIN numbers ever being requested or provided. Div. Br. 20.

Equity Trust minimizes Batt's active role in Taylor's solicitation at the New Birth Church event.[12] For example, Equity Trust claims that, when Taylor had Batt stand up for acknowledgement, Batt had a "deer-in-the-headlights frozen expression." Resp. Br. 13. On the contrary, Batt enjoyed being in the spotlight, as the photographs plainly show. DE 800-H-L. Crystal Turner and Lillian Wells, who were sitting near Batt, both testified that Batt was smiling and did not appear uncomfortable when he stood up during Taylor's introduction.[13] Tr. 22-23, 1353.

Contrary to Equity Trust's argument that Equity Trust's presence at New Birth Church did not impact investment decisions, testimony by investors establishes that Equity Trust's presence and conversations they had with Batt were significant to their decisions to invest. Ronald Jones, who spoke with Batt at New Birth Church, was unambiguous that "Equity Trust did endorse Mr. Taylor and City Capital" and that Batt's "glowing" remarks about Taylor "absolutely" had an effect on his decision to invest. Tr. 111-113, 145, 156-159. And following a

[12] Equity Trust also omits from its brief a number of Taylor's references to Batt and Equity Trust at the New Birth Church event, falsely stating that the two extracts in its brief are "everything Taylor said about Batt and ETC." Resp. Br. 13. In addition to those remarks, Taylor stated that "with Robert [Batts]'s bank . . . we can actually take that gas station and put it inside people's retirement accounts." DE 9 at 64. Taylor also stated "Robert [Batt] has this funny story. He called me one day, we're on the phone, I was like, 'Robert, I got this one client, want to know can he put pigs inside of his retirement account.' [Batt] was like, 'Yeah, we just did that.'" *Id.* at 67. And Taylor touted Equity Trust's website by urging the audience to "go to the bank's website and look at some of it.... There's a lawyer that made $900,000 off a $5,000 account, flipping apartment buildings." *Id.* at 75-76. Finally, in his closing remarks, Taylor urged the audience to speak with Batt when he said that "if you're really looking to make a change in your life just see anybody that has...a Wealth Tour Live badge," which Batt was wearing. DE 800-J.

[13] Equity Trust states that the New Birth event was the "first and only time anybody from ETC saw Taylor." Resp. Br. 12. At other times, however, Batt sought to arrange face-to-face meetings with Taylor. DE 18; Tr. 369; DE 27 (Batt to Taylor email: "when are you coming to Cleveland, I have a nice Brazilian steak house I want to take you [to]."). In addition, for nearly two years, Batt was in regular and sustained contact by phone and email with Taylor and others in City Capital's offices in North Carolina. *See, e.g.*, DE 11-12, 14-20, 23, 25-27, 270, 273-275, 278-294, 297-312, 314, 318, 321, 323-327, 329-332, 334-336, 338-340.

general conversation about self-directed IRAs, Batt walked Lillian Wells over to Taylor and told Taylor that Wells "was interested in setting up an account," even though Wells had not expressed an interest in investing with Taylor. Tr. 24-26.

Crystal Turner testified that when Batt was introduced by Taylor that she was impressed that "the bank actually flew [Batt] to Atlanta to be here for the presentation," and she believed that "this is legit because you don't often get big established banks sending their people to do business with a black guy in a predominantly black church." Tr. 1351-1352. When asked if Batt ever told her that he did not endorse Taylor, Turner responded: "No. He gave me the opposite feeling." Tr. 1356.

Other investors emphasized the role that Equity Trust played in endorsing and recommending Taylor. For example, as the ALJ found, Batt joined a conference call with Anita Dorio "to persuade her to switch her funds...to an investment with Taylor at Equity Trust." ID at 32. Lawrence Hill was unsure whether to invest with Taylor, and Taylor recommended that he call Batt. Tr. 171-172. Hill called Batt, and Batt told Hill that City Capital was "a good company" and that Taylor was "getting people right now 10 percent on their investment." Tr. 172, 372. That call gave Hill the comfort he needed to invest with Taylor. Tr. 173.

b. Poulson

Equity Trust argues that it had "limited interaction" with Poulson. Resp. Br. 18-19. This is contradicted by, among other evidence, Equity Trust's internal emails stating that its goal was to "partner" with Poulson and to "support" him from a "marketing perspective." DE 146 at 1; DE 145.

Significantly, Equity Trust and Poulson entered into agreements to sponsor each other's events, although it now claims that "neither actually did so." Resp. Br. 19. As explained in the

Division's Brief, numerous emails between Equity Trust and Poulson demonstrate that Poulson and Equity Trust agreed to sponsor each other's events, and that the terms of the payments were also agreed upon. Div. Br. 28-30. As a result of Equity Trust's sponsorship of Poulson's monthly events, Poulson exclusively referred investors to Equity Trust and sent Equity Trust the contact information of attendees at his events. *Id.*

Equity Trust also incorrectly characterizes Equity Trust's attendance at Poulson's solicitation event, suggesting the event was strictly "educational." Resp. Br. 18. The "Extravaganza" that Equity Trust attended – and Poulson's events more generally – were a platform from which Poulson promoted his promissory note scheme. Tr. 1113-14 (Savary); Tr. 1259-1260 (Gatto). Equity Trust knew from its communications with Poulson that his "educational" events could not be separated from his note offerings. In a 2008 email to Irene Berlovan, Poulson boasted that "I have probably worked with 10 or 12 customers of Equity Trust [...] most of whom I referred" and "I frequently use private money in my real estate investment business to complete and settle transactions..." DE 144 at 2. In another example, Jeanette Arnholt emailed J. Desich among others that Poulson was "a client" who "had consistently been referring people to us." DE 150.

Berlovan also appeared on stage with Poulson and told investors that her job was to "help investment sponsors like Randy." DE 262-A (video). Glenn Savary invested with Poulson after he attended Poulson's event where Berlovan was introduced as a member of Poulson's power team. DE 746 at 9; DE 262 at A-B. And Joseph Gatto invested with Poulson after hearing Berlovan's "glowing recommendation" about Poulson at the April 2009 "Extravaganza" that Berlovan and Edwin Kelley attended. Tr. 1262. Gatto testified that Berlovan gave a "ringing endorsement of Mr. Poulson." Tr. 1341.

2. Taylor's and Poulson's "Public Profiles" Are Irrelevant

Equity Trust argues that individuals invested with Taylor and Poulson because of their "public profiles." A respondent, however, can be liable for causing a violation even if there were other causes. *Erik W. Chan*, Rel. No. 8078, 2002 WL 507022, at *31 (Apr. 4, 2002) (Comm'n Op.) ("[T]he mere fact that others also may have caused [a primary violation of] the securities laws does not insulate [respondent] from liability for his own acts and omissions.").

In any event, the public profiles of Taylor and Poulson are irrelevant to whether Equity Trust acted reasonably. Among other reasons, Equity Trust knew that Taylor's and Poulson's investments did not have the proper documentation, which itself was a red flag that should have resulted in Taylor and Poulson being placed on the Do Not Process list. And Equity Trust knew that Taylor made false statements before an audience of thousands about Equity Trust's role. Equity Trust also knew that Taylor and Poulson were not repaying the substantial majority of investors.

Equity Trust also argues that, before 2010, Taylor was universally considered a "highly successful business person" who was regarded "uniformly...in strongly positive terms." Resp. Br. 9. The witnesses that Equity Trust cites to support this position – Raoul Davis, Linda Keeton-Cardno, and Robert Bovarnick – actually prove the opposite. Davis, Taylor's public relations consultant, testified that when he became aware at the New Birth event that Taylor was peddling promissory notes to investors he "became upset with [Taylor]...[because] the company was in debt...[and] that just did not seem like a good formula to me." Tr. 1690-1691. Keeton-Cardno, a consultant who worked on City Capital's audits, testified that City Capital and Taylor were "sustaining themselves by...basically issuing notes for cash" and that "going concern" opinions were issued every year.[14] Tr. 1740-1742. And Bovarnick, City Capital's lawyer, helped defend Taylor and his entities against a string of lawsuits against Taylor from 2006 through 2009. Tr. 1793-1800; DE 816-820.

D. Equity Trust's Flawed and Misleading Arguments Regarding the Expert Witnesses

While the ALJ disregarded the views of both parties' experts, the core duties of a reasonable IRA custodian are straightforward: a reasonable custodian should not endorse or promote issuers or investments; should take custody of documentation evidencing its customers' investment intent; should avoid conflicts of interest; should adopt reasonable policies and procedures; and should respond reasonably to red flags. Equity Trust has never disputed any of these basic responsibilities of an IRA custodian.

Nonetheless, Equity Trust's brief criticizes the qualifications of the Division's expert witness, William Ries, claiming that Ries has "absolutely no experience with SDIRAs or their custodians, and thus no familiarity with current SDIRA industry standards and practices." Prior to and at the hearing, however, Equity Trust never objected to Ries's qualifications or opinions. As a result, Equity Trust has waived any objection to Ries's qualifications. *Meza v. Colvin*, 2015 WL 5773751, at *6 (D. Colo. Sept. 30, 2015) (plaintiff "waived the qualification argument by failing to object" to expert's qualification before Administrative Law Judge). *See also Skydive Ariz., Inc. v. Quattrocchi*, 673 F.3d 1105, 1113-14 (9th Cir. 2012) (failure to challenge an expert's qualifications at trial results in waiver of the right to raise objections to the substance of expert testimony post-trial).

---

[14] City Capital's Form 10-K for *2007* disclosed "recurring losses from operations and negative cash flows" and that its auditors had "substantial doubt about [City Capital's] ability to continue as a going concern." DE 537 at 24. Equity Trust, which monitored City Capital's public filings, knew or should have known of this highly negative information, which was publicly available at the same time Taylor first became a "center of influence." Tr. 1585.

Ries's extensive expertise in bank, trust, custodial, and fiduciary law make him more than qualified to opine on the duties of a custodian like Equity Trust, to identify when a purportedly passive custodian exceeds those bounds, and to explain the consequences of failing to act passively. Equity Trust fails to address Ries's opinion that Equity Trust's promotion and endorsement of Taylor and Poulson meant that it was required to act commensurate with its conduct. For example, Equity Trust does not dispute Ries's testimony that if custodians "take[] on duties and responsibilities that are outside the scope of the duties and responsibilities set forth in the custody agreement, the custodian is responsible for performing those additional duties in accordance with the standard of care applicable for the services provided." DE 39 at ¶¶ 8, 22.

Equity Trust's only rebuttal to Ries came from the opinion of its expert, Terry Prendergast, who submitted a misleading report that is premised on the applicability of a South Dakota statute dealing with "Directed Trusts," S.D.C.L. § 55-1B ("Section 55"), which Prendergast says that Ries "ignored." Under Prendergast's theory, Section 55 makes Equity Trust an "excluded fiduciary" and therefore is not liable for any loss, has no duty to perform investment or suitability reviews, and is also relieved of any duty to communicate with, warn, or apprise any party. DE 223. In Prendergast's extreme view, Section 55 makes Equity Trust immune from the consequences of its acts or omissions.

The fundamental problem with Prendergast's opinion is that Equity Trust is not an excluded fiduciary under Section 55. Tom Simmons, a law professor and South Dakota lawyer, concluded that Section 55 does not apply because Equity Trust is not a "Directed Trust" under South Dakota law.[15] DE 836 (Simmons Report). In addition, Section 55, by its own terms, does

[15] Equity Trust also claims that Simmons has "absolutely no SDIRA experience." Resp. Br. 2-3. As is the case with Ries, Equity Trust never objected to Simmons' qualifications as an

not apply where a custodian has communications directly with the account holder about the suitability of an investment. DE 836 at 5. Scott Kelly, from the South Dakota Division of Banking, also confirmed that Section 55 does not apply because Equity Trust is not a "Directed Trust" under South Dakota law. Tr. 1159-1160. As a result, Prendergast's conclusions, which depend on the applicability of Section 55, are wrong and unreliable.[16] And even if Section 55 did apply, it would not protect Equity Trust from liability because it did not conduct itself as a passive custodian. DE 836 at 4-5.

II. EQUITY TRUST'S CROSS-PETITION FOR REVIEW IS WITHOUT MERIT

Equity Trust's cross-petition argues that: (1) Equity Trust's acts and omissions were not a cause of the violations; (2) the underlying violations were scienter-based; therefore, proof of negligence is insufficient; (3) the primary violations by Taylor and Poulson were not proven and, in any event, the Taylor and Poulson Notes were not securities; and (4) the proceedings violated the Constitution. The ALJ correctly rejected each of these arguments.

A. The ALJ Correctly Found that "Acts and Omissions" by Equity Trust Were a Cause of the Violations

The ALJ correctly found, in satisfaction of the second causing element, that Equity Trust was "a cause" of Taylor's and Poulson's violations because Equity Trust's "services to its customers facilitated the receipt and retention of investor funds by the fraudsters, making their frauds successful." ID at 32. In addition, the ALJ found that Equity Trust, with respect to Dorio,

---

expert before or during the hearing. As a result, it has waived any objection to Simmons' qualifications. *Meza*, 2015 WL 5773751, *6.

[16] In addition, as the Simmons Report stated, Section 55 does not apply because Equity Trust's custodial agreement – which Equity Trust insists governs the relationship with its customers – does not refer to or incorporate Section 55. Instead, the custodial agreement provides that it is to be "governed by and construed under the applicable laws of the State of Ohio." *See, e.g.*, DE 696 at 125 (Section 8.15); DE 836 at 3-4 (Simmons Report).

was a cause of Taylor's violations because Batt helped "persuade her to switch her funds...to an investment with Taylor at Equity Trust," which constituted a "recommendation to invest." ID at 32, 36. In fact, the ALJ found "Batt's efforts to persuade Dorio to invest with Taylor" to be so significant as to "potentially fall within the definition of 'investment adviser.'" ID at 36 n.40.

Equity Trust now argues that the Division did not satisfy the second causing element for two reasons: (1) Equity Trust was not a cause of Taylor's or Poulson's "misconduct," and (2) Equity Trust was not a cause of individuals deciding to invest with Taylor and Poulson. Resp. Br. 20-29.

Equity Trust misstates the legal standard. Under Section 8A, causing liability results not from causing another person's "misconduct," as Equity Trust argues, but from being "a cause of the ***violation***," where the act or omission is one the person knew or should have known "would contribute to such ***violation***." 15 U.S.C. § 77h-1(a) (emphasis added). *See, e.g., KPMG Peat Marwick LLP*, Rel. No. 1360, 2001 WL 47245 at *19 (Jan. 19, 2001), *aff'd*, 289 F.3d 109 (D.C. Cir. 2002) (referring to whether a person "is alleged to 'cause' a primary ***violation***").

The Division must prove, and has proven, that Equity Trust's acts and omissions were "a cause" of Taylor's and Poulson's violations. At minimum, and as the ALJ found, Equity Trust was "a cause" of the violations by receiving and processing account documentation and then negligently sending investor funds in exchange for Taylor and Poulson Notes.[17] In fact, because Taylor and Poulson encouraged their investors to use Equity Trust, and because Taylor and Poulson used Equity Trust almost exclusively, investors had little choice but to invest through Equity Trust. Div. Br. 14, 28-29.

[17] Accordingly, the ALJ correctly rejected Equity Trust's argument that "its account-opening, investment processing, record-keeping, and marketing activities were unrelated to Taylor's and Poulson's misrepresentations and misuse of funds." ID at 32.

In addition, Equity Trust was "a cause" of the violations by entering into sales and marketing relationships with Taylor and Poulson that included negligently endorsing, sponsoring, and recommending them to numerous investors.[18]

Equity Trust argues that (Resp. Br. 21-27) other factors led investors to invest with Taylor and Poulson. But whether or not there were additional causes of the violations is not relevant. *Rita J. McConville*, Rel. No. 2271, 2005 WL 1560276, at *12 n. 45 (June 30, 2005) (Comm'n Op.), *pet. denied*, 465 F.3d 780 (7th Cir. 2006); *Erik W. Chan*, Sec. Rel. No. 8078, 2002 WL 507022, at *8 (Apr. 4, 2002) (Comm'n Op.) ("[T]he mere fact that others also may have caused [a primary violation of] the securities laws does not insulate [respondent] from liability for his own acts and omissions."); *Harrison Securities, Inc.*, Rel. No. 256, 2004 WL 2109230, at *47 (Init. Dec. Sept. 21, 2004) (Finality Order Oct. 29, 2004) (quoting Black's Law Dictionary: "contributing cause" is "a factor that – though not the primary cause – plays a part in producing a result").

B. Evidence of Equity Trust's Negligence Is Sufficient Because the Primary Violations Are Non-Scienter

Equity Trust argues that the Division must prove that Equity Trust acted with scienter because, according to Equity Trust, "the underlying primary violation required proof of scienter." Resp. Br. 29. The ALJ, however, correctly rejected this argument. ID at 30-31. As

[18] Equity Trust also cites (Resp. Br. 25) to the report of one of its expert witnesses, Kurt Carlson, who admitted that he had no experience or knowledge of securities cases or investment fraud. Tr. 1457-1458. Based on an unreliable online survey, Carlson gave the factually wrong and totally irrelevant opinion that Equity Trust "did not positively influence prospective investors' willingness to invest with Taylor or Poulson." RE 224 at 14. Carlson based his opinion on an online response from unseen persons located in, among other locations, Tunisia, Colombia, Taiwan, India and Turkey, who were paid 50 cents each. Tr. 1499-1501. Even taken at face value, however, Carlson's opinion is irrelevant because it concerns reliance, which is not an element of the Division's burden of proof, as the ALJ noted during the proceeding. Tr. 1475-1476. Of course, investors testified at the hearing that Equity Trust did, in fact, positively influence their decision to invest with Taylor.

the OIP charged Equity Trust with causing Taylor's and Poulson's violations of Sections 17(a)(2) and (a)(3) of the Securities Act, which are non-scienter violations, "[n]egligence is sufficient to establish liability for causing a primary violation that does not require scienter." ID at 30.

The ALJ's conclusion that negligence is sufficient when the primary violation is non-scienter is supported by the Commission's clear holding in *KPMG*: "We hold today that negligence is sufficient to establish 'causing' liability under Exchange Act Section 21C(a), at least in cases in which a person is alleged to 'cause' a primary violation that does not require scienter." *KPMG*, 2001 WL 47245 at *20. On appeal, the D.C. Circuit affirmed that "negligence is an appropriate basis" for causing violations that do not require scienter. 289 F.3d at 126.

Equity Trust argues that because Taylor and Poulson were convicted of scienter-based conduct in the criminal cases, and Taylor was charged with scienter and non-scienter conduct in the Division's case, scienter should be required in this proceeding. This has never been the case, and the only authority is to the contrary: a respondent can negligently cause violations of Sections 17(a)(2) and 17(a)(3) even if there are also scienter-based primary violations. *See, e.g., Daniel Bogar*, Rel. No. 502, 2013 WL 3963608, at *23-24 (Init. Dec. Aug. 2, 2013); *Albert Glenn Yesner*, Rel. No. 184, 2001 WL 587989, at *29-30 (Init. Dec. May 22, 2001).

C. The Evidence Proves the Primary Violations

Equity Trust's baseless argument that the primary violations are "not proven," and that the Taylor and Poulson Notes are not securities, Resp. Br. 29-31, should be rejected. As the ALJ found, "Taylor and Poulson each violated Securities Act Sections 17(a)(2) and 17(a)(3)." ID at 31. Taylor and Poulson each made "misrepresentations [that] were clearly material" and "also engaged in a course of business that operated as a fraud on the purchasers of his notes." ID at 31.

Sufficient evidence of the primary violations is contained in Taylor's guilty plea allocution, when he admitted to operating a scheme to defraud investors and to making material misrepresentations and omissions. DE 1, 3-7, 36 at 6 (17-18). In addition, the Division submitted extensive evidence – unchallenged by Equity Trust –that proves Taylor's primary violations. Using investor files, bank records, City Capital financial records and other documents, the Division summarized the $5.3 million that Ephren Taylor and City Capital raised from Equity Trust customers from April 2008 through December 2009. DE 40. The Division also proved that the vast majority of investor funds were not used on investment related activity, but instead were commingled with other funds and were used primarily to pay City Capital's operating expenses, with a small amount returned to investors. DE 40 at 3-5. This was not consistent with investors' understanding of how their funds would be used. *See e.g.*, Tr. 102 & 136 & 139 (Jones); Tr. 185 (Hill); Tr. 1431-1432 (Sims); Tr. 804-805 & 811 (Dorio). This conduct was at least negligent.

Taylor also violated Sections 17(a)(2) and 17(a)(3) through his false statements to the attendees at New Birth Church, and because he and City Capital falsely represented to investors on 35 occasions, including through Equity Trust's DOIs, that Taylor Notes were secured when in fact they were unsecured. Div. Br. 33-36; DE 36 at 24 (90-91) (City Capital filled out DOI and falsely indicated certain notes were secured when they were not); DE 40 at 30. Taylor's and City Capital's primary violations started at least as early as 2008. *See, e.g.*, DE 40 at 3-5 (showing misuse of funds starting as early as 2008); Tr. 165-193 (Hill: investment in Taylor Note in June 2008).

Like Taylor, Poulson admitted his illegal conduct during his plea allocution, including that his scheme occurred from July 2006 through November 2011. DE 269 at 2 (indictment); DE 267 at 32 (plea colloquy). In his hearing testimony, Poulson admitted to his conduct constituting the primary violations. Tr. 492-494.

The Division also summarized Poulson's bank records, investor files and account statements, and the total investments made by Poulson's investors. From 2008 through 2011, Poulson commingled funds into a single account and used these funds for personal expenses, including vacations, credit card payments, his children's tuition, and life insurance premiums. DE 41 at 2-3 (Daniello Decl.); Tr. 502-504.

Poulson acted at least negligently by commingling customer funds and using those funds for personal expenses and in other ways not disclosed to investors. Tr. 1117 (Savary); Tr. 1322 (Gatto). *See SEC v. Murphy*, 626 F.2d 633, 638 (9th Cir. 1980); *SEC v. Brooks*, 99 Civ. 1326, 1999 WL 493052, at *2 (N.D. Texas 1999).

In addition, Poulson unreasonably failed to record mortgages securing the Poulson Notes, which resulted in a worse lien position and served to cover up the scheme. DE 41 at 4-5, 29; Tr. 503 (Poulson), 1766 (Jablonski); 1098 (Savary); 1274 (Gatto). Poulson also unreasonably issued Poulson Notes without informing investors that there were multiple unrecorded mortgages associated with those properties, thus lessening the value of the properties as security. *Id.* These misrepresentations were material.

Finally, Equity Trust argues that the Taylor and Poulson notes were "simple loans," not securities. Resp. Br. 30-31. The ALJ, however, after applying the *Reves* test, found that "[t]he Taylor and Poulson notes were securities within the meaning of the Securities Act." ID at 31. *Reves v. Ernst & Young*, 494 U.S. 56, 66-67 (1990).

Application of the four *Reves* factors leaves little doubt that the Taylor Notes and Poulson Notes are securities. First, Taylor and Poulson intended for the Notes to raise money for their business enterprises or to finance investments. City Capital's ostensible business involved "buying and acquiring real estate and acquiring small businesses" and funding operations "[t]hrough borrowing capital" primarily from "small investors or the general public." DE 36 at 7 (23). Similarly, Poulson's purported business purpose was to raise money to fix up properties and sell them at a profit. Tr. 547-550. Investors understood that their funds would be invested in business enterprises (in the case of Taylor) and real estate (in the case of Poulson). And clearly the purchasers of the notes – looking to increase their retirement nest eggs – were motivated by the investment profits they hoped the Notes would generate. *See, e.g.*, Tr. 136 & 139 (Jones); Tr. 185 (Hill); Tr. 1431-1432 (Sims); Tr. 804-805 & 811 (Dorio); Tr. 1117 (Savary); Tr. 1322 (Gatto).

Second, the Notes were offered and sold to a broad segment of the public. As Taylor traveled around the country pitching the Taylor Notes, he solicited "investors via advertising: media, radio, direct mail, seminars, events." DE 36 at 7 (23). Similarly, Poulson advertised widely and promoted his marketing events, which were opportunities for him to offer and sell Poulson Notes to the public. *See, e.g.*, DE 44; Tr. 1258 (Gatto); DE 150; DE 160; Tr. 1275-1276 (Gatto); Tr. 1343 (Gatto); Tr. 1336 (Gatto); Tr. 1066-1071 (Savary); DE 746; DE 262 at A-B. The plan of distribution was more than sufficient for the Notes to be considered securities. *See Deal v. Asset St. Gr.*, 92 Civ. 187, 1992 WL 212482, at *4 (N.D. Ill. Aug. 28, 1992) (finding that an offering of notes to six investors evidenced the wide offering of the notes)..

Third, the public reasonably viewed the Poulson and Taylor Notes as investments. Both Notes were repeatedly characterized as "investments," and Taylor and Poulson promoted them as investments. The investors viewed the self-directed IRA as an alternative retirement investment option compared with investments like mutual funds. *See, e.g.*, Tr. 172-173, 184 (Hill); Tr. 111-112 (Jones); Tr. 1428 (Sims); Tr. 1070-1071 (Savary); Tr. 1258-1259 (Gatto). *See also George J. Kolar*, Rel. No. 152, 1999 WL 977373, at *21 (Oct. 28, 1999) ("all viewed the note holders as 'investors'"). In addition, Taylor and Poulson repeatedly referred to the noteholders as "investors" and the notes as "investments." *See, e.g.*, DE 36 (23, 64, 308); Tr. 563; Tr. 565. Finally, there are no risk-reducing factors, such as FDIC insurance, to suggest the Notes are not securities. Contrary to Equity Trust's suggestion, phony collateralization does not constitute a risk-reducing factor. *See Mercer v. Jaffe, Snider, Raitt and Heuer, P.C.*, 736 F. Supp. 764, 770-771 (W.D. Mich. 1990) (finding "first mortgage notes" were securities under *Reves*; "purchasers were in fact unsecured because [they received] fraudulent mortgages to secure their notes").

D. Equity Trust's Constitutional Arguments Are Without Merit

Equity Trust makes three brief constitutional arguments, all of which were properly rejected by the ALJ. First, Equity Trust argues that the Commission's method of hiring of ALJs and the manner for their removal violate the Appointments Clause of the Constitution. These arguments fail. As the Commission has held, the Commission's ALJs are employees, not constitutional officers, and thus are not subject to Article II's requirements. *See, e.g.*, *Raymond J. Lucia Cos., Inc., et al.*, Rel. No. 4190, 2015 WL 5172953, at *21 (Sept. 3, 2015), *aff'd*, *Raymond J. Lucia Cos. v. SEC*, 832 F.3d 277, 2016 WL 4191191 (D.C. Cir. Aug. 9, 2016) (rehearing petition pending); *Timbervest, LLC, et al.*, Rel. No. 4197, 2015 WL 5472520, at *23-26 (Sept. 17, 2015).

Second, Equity Trust asserts that the administrative forum affords them inadequate due process; in particular, they allege that the Commission's Rules of Practice unfairly limit their ability to take discovery. The Commission and the courts, however, have repeatedly rejected "[s]uch broad attacks on the procedures of the administrative process." *Harding Advisory LLC*, Securities Act Release No 9561, 2014 WL 988532, at *8 (Mar. 14, 2014); *see also, e.g., Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519, 543 (1978) (recognizing that agencies "should be free to fashion their own rules of procedure"); *McClelland v. Andrus*, 606 F.2d 1278, 1285-86 (D.C. Cir. 1979) (federal procedural rules are inapplicable in administrative hearings).

Finally, Equity Trust complains that there is no right to trial by jury in an administrative proceeding. It is well settled, though, that Congress "may assign th[e] adjudication" of cases involving "public rights" to "an administrative agency with which a jury trial would be incompatible[] without violating the Seventh Amendment[] ... even if the Seventh Amendment would have required a jury where the adjudication of those rights is assigned instead to a federal court of law." *Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n*, 430 U.S. 442, 455 (1977); *see also Tull v. United States*, 481 U.S. 412, 418 n.4 (1987) ("[T]he Seventh Amendment is not applicable to administrative proceedings.").

To the extent Respondents also suggest that it was improper for the Commission to elect to proceed administratively in this action, rather than in district court, that claim also fails. There is nothing untoward about the Commission's instituting proceedings in the forum that Congress made available. *See Jarkesy v. SEC*, 805 F.3d 9, 12 (D.C. Cir. 2015) ("Nothing in Dodd–Frank or the securities laws explicitly constrains the SEC's discretion in choosing between a court action and an administrative proceeding when both are available."); *SEC v. Citigroup Global Markets, Inc.*, 752 F.3d 285, 297 (2d Cir. 2014) (citing enforcement mechanisms available in administrative proceedings and holding that "to the extent that the S.E.C. does not wish to engage with the courts, it is free to eschew the involvement of the courts and employ its own arsenal of remedies instead").

III. SIGNIFICANT REMEDIES SHOULD BE IMPOSED

A. Disgorgement and Prejudgment Interest Are Appropriate

The Division seeks disgorgement of $180,336.18 in account fees. Div. Br. 48. Equity Trust argues that the Division has offered "no proof" of its disgorgement amount and also "no proof" that the fees were not received "through legitimate activities." Resp. Br. 33-34. Equity Trust is wrong. The fees that Equity Trust received from administering the Taylor and Poulson accounts are a reasonable approximation of the profits Equity Trust received from its violations and should be disgorged. *See John Thomas Capital Mgmt. Group LLC*, Rel. No. 693, 2014 WL 5304908, at *30 (Init. Dec. Oct. 17, 2014) ("Management fees [] are appropriately disgorged where they constitute ill-gotten gains earned during the course of violative activities"), *rev. granted*, Rel. No. 3978, 2014 WL 6985130 (Dec. 11, 2014); *Bogar*, 2013 WL 3963608, at *26 ("commissions from management fees are appropriately disgorged where they constitute ill-gotten gains earned during the course of violative activities").

"'Once the Division shows that the disgorgement is a reasonable approximation, the burden shifts to the respondent to show that the amount of disgorgement is not a reasonable approximation. The risk of uncertainty in calculating disgorgement should fall on the wrongdoer whose illegal conduct created that uncertainty.'" *Scott M. Stephan*, Rel. No. 888, 2015 WL 5637557, at 3 (Sept. 25, 2015).

The Division's fee calculations derive from Equity Trust's own Account Transaction Detail reports. These reports list, on a customer-by-customer basis, account fees that Equity Trust received from Taylor and Poulson customers through deductions from the custodial accounts. DE

797, 798. Equity Trust does not dispute that the Account Transaction Detail reports accurately list the fees paid by Taylor and Poulson customers. For customers for whom Equity Trust provided no such reports, the Division used the average fee amount of those customers with reports, as set forth on Attachment A.

Equity Trust also claims that the Division has not established "what portion of the fees were paid on customers' behalf by City Capital." Resp. Br. 33. This is not correct. The Division submitted evidence, based on City Capital's accounting records and bank checks, that City Capital paid $62,598.81 in customer fees to Equity Trust. DE 40 at 7, 25-27. Equity Trust stipulated to the admission of this summary without objection. Tr. 11.

Equity Trust's overblown argument that the Division's disgorgement calculation has caused it "substantial prejudice" should be rejected. Resp. Br. 33. Several weeks before the trial, per the ALJ's order, the Division informed Equity Trust that it would seek disgorgement of approximately $180,000 in fees. *See* Tr. 1853-1854. Similarly, the Division's pre-hearing brief stated that the Division would seek "approximately $180,000" in fees.[19] During the hearing, Equity Trust never challenged the Division's estimate that it received $180,000 in fees.

Equity Trust also falsely states that "the Division's witnesses did not address disgorgement at all." Resp. Br. 33. In fact, there was substantial testimony on the fees that Equity Trust charged its customers. DE 36 at 40 (154) (Taylor); Tr. 36 (Wells); Tr. 100-101 (Jones); Tr. 393 (Batt).

[19] Equity Trust alternatively could be ordered to provide an accounting to determine the amount of its fees. The Division's pre-hearing brief (at 23) proposed that "ET should be ordered to prepare an accounting to determine the exact amount" of fees subject to disgorgement, and the OIP (§ III.B) also stated that Equity Trust might be required to "provide an accounting."

Dea also testified that, due to an "oversight," Equity Trust continued to charge customers fees even after City Capital was placed on the Do Not Process list. Tr. 757-758, 760.[20]

Equity Trust also argues that some portion of fees might have been received from legitimate activities. In this instance, however, all of the fees earned from the Taylor and Poulson accounts should be disgorged. Equity Trust had a narrow role as an IRA custodian, and it deviated from that role throughout the relevant period by, among other things, failing to custody account documentation and endorsing, sponsoring, and recommending Taylor and Poulson. The fees it earned, then, resulted from its violations. In any event, Equity Trust offers no method to distinguish or identify fees earned from legitimate activities.

Equity Trust offers no persuasive alternative to the Division's reasonable approximation of disgorgement. As a result, the Commission should order Equity Trust to disgorge $180,336.18 in fees, plus prejudgment interest.

B. A Significant Civil Penalty Is Appropriate

Equity Trust's arguments that civil penalties are not appropriate, and if they are, they should be limited to "one course of action," should be rejected. Resp. Br. 34. It is in the public interest to impose stringent penalties against Equity Trust for its misconduct. *See J.S. Oliver Capital Management, L.P.*, Rel. No. 10100, 2016 WL 3361166, at *13-16 (June 17, 2016) (Comm'n Op.) (setting forth the factors in considering a civil monetary penalty). Equity Trust was clearly on notice for years that issuers regularly perpetrated frauds through self-directed IRAs, including accounts at Equity Trust. Div. Br. 5-8. For example, the Desiches were already the subject of a Cease-and-Desist Order issued by the State of Ohio in 2009 that described

[20] Equity Trust suggests that some of these fees may have been "refunded to customers," Resp. Br. 33, but fails to offer any evidence of refunds. Customer refunds would be information within Equity Trust's possession.

similar conduct. In the face of these risks, Equity Trust recklessly encouraged its employees to develop sales and marketing relationships with issuers, which resulted in Equity Trust promoting, sponsoring, and recommending Taylor and Poulson. Div. Br. 11-31. Equity Trust knew, or at least should have known, that it was contributing to the primary violations here, and those acts and omissions, spanning more than three years, helped wipe out the retirement savings of approximately 100 individuals, many of whom testified about the heartbreaking results of those losses.

Equity Trust has also repeatedly shown that it will change its business practices only when compelled to do so. As Scott Kelly testified, Equity Trust's compliance culture was "reactionary as opposed to proactive," and it only added compliance personnel at the Division of Banking's insistence. Tr. 1193. Equity Trust even sought to circumvent any oversight into the most problematic areas of Equity Trust – the sales and marketing departments – by putting those departments into an affiliate company that was not subject to Division of Banking regulation. Tr. 1179-1182. Indeed, Scott Kelly testified that he was not even aware that Equity Trust had sales and marketing departments or that an Equity Trust employee went to the event at New Birth Church. Tr. 1179-1184.

In addition, Equity Trust is wrong to suggest that the penalty should be limited to "one course of action." The Commission has considerable discretion in how to count the number of "acts and omissions" for penalty purposes. *J.S. Oliver Capital Management, L.P.*, 2016 WL 3361166 at 15. Equity Trust does not dispute that on 19 separate occasions it processed Taylor or Poulson Notes, or replacement Notes, during the relevant penalty period (July 22, 2010 through the filing of the OIP). Each of those individual acts contributed to a fraud on an individual investor, including 9 new additional Poulson investors. And each of the 10 renewals of Poulson Notes and 2 renewals of Taylor Notes – which included new terms and a new principal amounts – constituted separate securities transactions that permitted Poulson and Taylor to continue operating their frauds without being discovered by investors, as the ALJ found. ID 32. In light of these separate acts, and the egregiousness of Equity Trust's conduct and the harm it caused, maximum penalties are warranted for Equity Trust's 19 acts and omissions. *J.S. Oliver Capital Management, L.P.*, 2016 WL 3361166, at 17 ("Respondents' misconduct involved repeated calculated violations of the securities laws, and its gravity does not merit that we assess only a single penalty for an ongoing course of conduct.").

C. Cease-and-Desist Order and Compliance Consultant Are Appropriate

A cease-and-desist order and compliance consultant are appropriate for similar reasons that a civil penalty is necessary. Equity Trust continues to function as an IRA custodian, with the same senior officers – the Desiches and Dea – who were in control during the period of wrongdoing, and who are recidivists. Div. Br. 5-6. Given that Equity Trust not only refuses to concede any misconduct or express any intent to take corrective actions, the need for a cease-and-desist order and compliance consultant is even more compelling. *See KPMG*, 289 F.3d 109, 124-125 (cease-and-desist order appropriate where there is evidence of "some risk" of future violations); 15 U.S.C. § 77h-1(a).[21]

[21] Equity Trust's suggestion that "never before" has a custodian been charged by the Commission with causing is not accurate. Resp. Br. 32. In two settled cases, the Commission charged banks that were acting as custodians with causing violations by fraudsters of Sections 17(a)(2) and 17(a)(3), and ordered the banks to pay penalties of $1 million and $10 million. *See* Lit. Rel. No 21215 (Sept. 21, 2009) (Regions Bank; cease-and-desist order at Securities Act Rel. No. 9065); Press Rel. 2007-187 (Sept. 19, 2007) (HSBC Bank; cease-and-desist order at Securities Act Rel. No. 8844).

CONCLUSION

The Division of Enforcement respectfully requests that the Commission reverse the Initial Decision; find that Equity Trust is liable under Section 8A of the Securities Act; and impose appropriate sanctions on Equity Trust.

Dated: New York, NY
October 31, 2016

Respectfully submitted,

DIVISION OF ENFORCEMENT

David Stoelting (212.336.0174)
Andrew Dean (212.336.1314)
Securities and Exchange Commission
Brookfield Place
200 Vesey Street, Suite 400
New York, NY 10281-1022
212.336.1323 (fax)

CERTIFICATE OF COMPLIANCE

I hereby certify pursuant to Rule 450(d) that the Division of Enforcement's Reply in Support of Its Petition for Review and Opposition to Respondent's Cross-Petition dated October 31, 2016 complies with the length limitations set forth in the Commission's Order dated August 16, 2016. The Division's Brief is 9,846 words .

David Stoelting

CERTIFICATE OF SERVICE

I hereby certify that on October 31, 2016, I filed the Division of Enforcement's Reply Brief in Support of Its Petition for Review and Opposition to Respondent's Cross-Petition dated October 31, 2016 with the Office of the Secretary of the Commission via facsimile at (202) 772-9324, and to alj@sec.gov, and served copies on the following person by email and by overnight courier to:

Brent J. Fields, Secretary (3 copies plus original)
Office of the Secretary
Securities and Exchange Commission
100 F Street N.E., Mail Stop 3628
Washington, DC 20549

Stephen J. Crimmins, Esq. (email to Stephen.Crimmins@mmlawus.com
Murphy & McGonigle PC
555 13th Street NW
Washington DC 20004
(Counsel for Respondent)

Howard Groedel, Esq. (email to hgroedel@ulmer.com)
Ulmer & Berne LLP
Skylight Office Tower
1660 West 2nd Street, Suite 1100
Cleveland, OH 44113
(Counsel for Respondent)

David Stoelting