U.S. SECURITIES AND EXCHANGE COMMISSION

Matter of

EQUITY TRUST COMPANY, A.P. File No. 3-16594

Respondent.

RESPONDENT'S POST-HEARING BRIEF

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Respondent Equity Trust Company ("ETC") files this post-hearing brief, including proposed findings of fact and conclusions of law, pursuant to Rule 340 of the Rules of Practice and as directed at the conclusion of the hearing.

As discussed below, the Division has not carried its burden of proving that ETC was a "cause" of the primary securities fraud violations it has alleged. "For 'causing' liability, three elements must be established: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that [its] conduct would contribute to the violation." *Matter of Spring Hill Capital Markets, LLC*, 2015 WL 7730856 at *12, I.D. Rel. 919 (Nov. 30, 2015) (ALJ Foelak). Based on the hearing testimony and exhibits, ETC requests that the Initial Decision (i) adopt the proposed findings of fact set forth below, (ii) conclude that ETC was not a cause of a primary securities law violation, and (iii) dismiss this proceeding in its entirety.

PROPOSED FINDINGS OF FACT

Based on the record evidence cited below, ETC requests that the Initial Decision make the following findings relating to (i) ETC and its role as a self-directed IRA custodian (Point I below); (ii) Ephren Taylor and his related entities, including City Capital Corporation (Point II); and (iii) Randy Poulson and his related entities, including Equity Capital Investments LLC and Poulson Russo LLC (Point III). (The Division's exhibits are cited below as "DX-__," and Respondent's exhibits are cited as "RX-__.")

I. ETC'S ROLE AS AN SDIRA CUSTODIAN

With offices in Ohio and South Dakota, ETC serves as custodian for over 130,000 self-directed individual retirement accounts ("self-directed IRAs" or "SDIRAs") holding over $12 billion in assets. It is one of the largest SDIRA custodians in the United States. Many major Wall Street financial firms regularly refer customers to ETC for custody of SDIRA assets that they do not handle, such as real estate. (Desich Tr. 961-64) As discussed below, its duties as an SDIRA custodian are appropriately limited, both as a matter of law and by contract.

As a South Dakota-chartered public trust company, ETC conducts its business subject to the regulation and biennial examinations of the South Dakota Division of Banking. (S. Kelly Tr. 1160) During these recurring examinations, state regulators have consistently determined that ETC ranked "2" on a scale of "5," meaning that its operations satisfied state regulators and that it is grouped with the vast majority of the dozens of trust companies the state regulates. State regulators saw ETC adopting the "best business practices" recommendations it received and viewed ETC as "improving" its operations over time. (S. Kelly Tr. 1194-1200)

A. Limited Duties of SDIRA Custodians

Congress, the courts and federal agencies all recognize that, in return for limited custodial fees, SDIRA custodians appropriately do not, among other things, (i) evaluate an investment's quality or legitimacy; (ii) perform research or due diligence on a customer's investment; (iii) check the accuracy of available financial information regarding the sponsor of any investment; (iv) assume responsibility for investment performance; (v) independently verify accuracy of reported valuation and other information related to the investment; or (vi) obtain independent appraisals of hard-to-value assets.

(1) Congress and the IRS. Decades ago, Congress specifically authorized the SDIRA model, which has proven successful as a tool for investors seeking to include alternative assets, most often real estate and notes, in their portfolios. Section 408 of the Internal Revenue Code permits a self-directed IRA to hold nontraditional investments such as promissory notes, unregistered securities, or real estate, while receiving the favorable tax treatment of an IRA. However the Code requires that the self-directed IRA must be held at an account trustee or custodian, such as ETC.

The Internal Revenue Service's Form 5305-A, the "model" IRA custodial agreement issued under 26 U.S.C. §408, "explicitly provides that ... the IRA account holder and account administrator ... might choose to limit each others' duties and responsibilities through exculpatory provisions." *Mandelbaum v. Fiserv, Inc.*, 787 F. Supp. 2d 1226, 1239, 1241-42 (D. Colo. 2011) (dismissing claims against SDIRA custodians where accounts invested in the Madoff Ponzi scheme, and where Madoff allegedly "required" investors to use the defendant custodians). IRA custodians are not fiduciaries:

> IRC §408(h) recognizes that custodial IRAs ... are not trusts. They are only treated as trusts for tax deferral purposes. Courts applying this section of the

> code in relation to custodial IRA accounts have held that IRC §408 and the corresponding regulations do not create any fiduciary or other duties of care. ...

Hines v. Fiserv, Inc., 2010 WL 1249838, at *3 (M.D. Fla. March 25, 2010).

As to reporting SDIRA asset values to the IRS annually, the IRS has made it clear that SDIRA custodians are not obliged to get independent appraisals of hard-to-value assets – assets without a regular trading market. In the leading IRS guidance, an August 6, 1993 response letter, Thomas Brisendine, Chief of Branch 1, Office of the Associate Chief Counsel for Employee Benefits and Exempt Organizations, states that in reporting valuation to the IRS, "[s]o long as the trustee [the IRA trustee or custodian] reports the information that it receives from the partners, it is under no obligation to appraise the investment independently." He adds that "[e]ven if the general partners are not forthcoming with the fair market value information, the trustees who are obligated to report FMV [fair market value] do not have to determine value independently to fulfill their obligation under the [Internal Revenue] Code." (RX-69, Siegel Declaration, ¶2-3, 5-6, Exs. A, C)

(2) Federal Courts. The courts have consistently held that "it is not plausible" for investors to look to SDIRA custodians "to seek out fraud or to perform fair market valuations." *Levine v. Entrust Group, Inc.*, 2013 WL 1320498, at *5 (N.D. Cal. Apr. 1, 2013). *Accord Grant v. Pensco Trust Co.*, 2013 WL 4772673, at *5-6 (N.D. Cal. Sept. 3, 2013); *Matkin v. Fidelity National Bank*, 2002 WL 32060182, at *3 (D.S.C. July 11, 2002) (custodial agreement similar to ETC's "clearly provides that Defendant maintained the SDIRA solely as a custodian, and did not undertake any other obligations with respect to Plaintiff's investment decisions"); *Abbott v. Chemical Trust,* 2001 WL 492388, at *8 (D. Kan. April 26, 2001) (in granting custodian's motion for summary judgment, district court held that "to the extent [the IRA custodian] owed a duty to [its account-holders], that duty was limited to executing the particular transactions requested by [the account-holders]"; *Holtz v. Hilliard,* 1 F. Supp. 2d 887, 890 (S.D. Ind. 1998) (IRA custodian "had no relationship with account holder which would even remotely support a duty to question his estate planning choices" and described custodian's duties as "holding retirement plan assets, making required tax law disclosures, and ensuring that the IRAs and retirement plans meet legal requirements of ERISA and other tax laws").

(3) Securities and Exchange Commission. The Commission has acknowledged that SDIRA custodians like ETC do not perform due diligence or an evaluation of the investments that customers choose to put in their SDIRAs. Specifically, the SEC has stated that SDIRA custodians: (i) "will generally *not* evaluate the quality or legitimacy of an investment and its promoters"; (ii) "likely have not investigated the securities or the background of the promoter"; (iii) "are responsible only for holding and administering the assets"; (iv) "explicitly state" in custodial agreements that the "custodian has no responsibility for investment performance"; and

(v) "usually do not investigate the accuracy of" any available financial information. (RX-46, "*SEC Investor Alert: Self-Directed IRAs and the Risk of Fraud,*" pp. 1-2).

In so acknowledging, the SEC has not expressed dissatisfaction with this limited role for SDIRA custodians or otherwise put them on notice as to any expanded duties. *Cf. WHX Corp. v. SEC*, 362 F.3d 854, 860 (D.C. Cir. 2004) (sanction vacated where, "[a]lthough WHX received informal indications that its provision violated the Staff's understanding of the rule..., there was no formal Commission precedent or official interpretive guideline on point"); *Monetta Financial Services, Inc. v. SEC*, 390 F.3d 952, 957 (7th Cir. 2004) (sanction vacated where "no rules expressly required disclosure").

(4) State Securities Regulators. On behalf of the state securities regulators that are its members, the North American Securities Administrators Association ("NASAA") has likewise acknowledged, in an investor alert less than a year ago, that an SDIRA custodian: (i) "does NOT research or perform due diligence reviews or recommend investments to clients"; (ii) "is a passive company that simply serves as an intermediary"; (iii) is "responsible only for holding and administering the assets" in an SDIRA; (iv) does "not evaluate the quality or legitimacy of any investment ... or its promotors"; (v) "only reports the information provided by the issuer and does NOT verify the accuracy of the information"; (vi) has as its "sole responsibility ... to report information to the IRS and from the issuer to the investor"; and (vii) is merely the keeper of the deposits to and distributions from the account," and "does NOT hold the investment funds or assets," which are transferred "to the issuer when an investment is made." (RX-47, NASAA, "*Third-Party Custodians of Self-Directed IRAs,*" pp. 1-2 (Dec. 2014))

NASAA's members are state regulators that have enforcement powers resembling the SEC's. This particular investor alert was prepared by a committee of state securities regulators to support NASAA's educational mission. NASAA's general counsel was not aware of any state regulators expressing opposition to what was stated in the alert, nor of any state regulators expressing the view that SDIRA custodians needed to do more than what is stated in this alert. (Mirko Tr. 1834-37, 1841-43) In a companion press release, the Washington State Securities Director, speaking as NASAA's president, stated that SDIRA custodians have "limited duties to investors" and that their "sole responsibility is to report information to the IRS and from the issuer to the investor." (RX-263; Mirko Tr. 1844-45)

(5) State Banking Laws. One Division expert, South Dakota attorney Tim Simmons, has argued that Ohio state banking law is relevant because ETC is headquartered in Ohio, and certain of its agreements incorporate Ohio law. In defining duties and standards for custodians, the relevant Ohio statute, Ohio Rev. Code § 5815.25 (B)-(D) (2013), provides that where the customer retains the power to "direct the acquisition, disposition, or retention of any investment," the custodian is an "excluded fiduciary" that is not responsible for losses resulting from the investment the customer has directed the custodian to make, and that it has no obligation to "perform investment reviews" or to "make recommendations" as to the customer's investment. *See also* Ohio Rev. Code § 5815.08(B); as provided in section 5815.25 of the Revised Code, a trustee is not liable for losses resulting from certain actions or failures to act when other persons are granted certain powers with respect to the administration of the trust.

Another Division expert, Pennsylvania attorney William Ries, has argued that South Dakota state banking law is relevant because ETC "is a state chartered non-depository trust company operating under the laws of the State of South Dakota." ETC "is regulated and subject to examination by the South Dakota Division of Banking." (DX-39, Ries Expert Report, ¶13, 15) However South Dakota law has a provision similar to the Ohio statute cited above. Under South Dakota Codified Laws, §55-1B-2 (2008) (RX-48), and other provisions of South Dakota law, as a custodian under a custodial account agreement, ETC had no duty to review or modify any direction from a custodial account owner, and ETC was not liable under South Dakota law, either individually or as a fiduciary, for any loss resulting from compliance with the account owner's direction. In particular, ETC had no duty to perform investment or suitability reviews, inquiries or investigations, or to make recommendations or evaluations with respect to any investments for which the custodial account owner could direct the acquisition, disposition or retention. South Dakota law also relieved ETC of any duty to communicate with, warn, or apprise any party concerning instances where ETC may have exercised its own discretion differently than the custodial account owner. (RX-222, Prendergast Expert Report)

B. Specific Limitations in ETC's Customer Agreements

With over 130,000 accounts, ETC processes many thousands of transactions every month. (Desich Tr. 989) Consistent with the Congressional, judicial and regulatory pronouncements discussed above, ETC has included lawful and appropriate disclaimers of duty in its "DOI" investment direction form, its custodial account agreement, and other core account documents. In these documents, ETC has stressed that it is the customer's job to select, evaluate, review and monitor the "self-directed" investments the customer was choosing to make, and that ETC is excluded from fiduciary and other duties in this regard.

(1) ETC's Direction of Investment (DOI) Form. ETC's custodial customers instructed their custodian ETC to make particular SDIRA account investments by sending ETC a so-called "DOI" or "Direction of Investment" form. The DOI form directed ETC to transfer out funds to make the investment indicated in the DOI form. Immediately above the ETC customer's signature at the bottom of each and every DOI form for each customer investment (RX-97-99, p. 4), it defined ETC's role and duties as follows:

> "My Retirement Account is self-directed and I, alone, am responsible for the selection, due diligence, management, review and retention of all investments in my account. I agree that the Custodian is not a 'fiduciary' for my account, as said term is defined in the Internal Revenue Code, ERISA or any other applicable federal, state or local laws. ..."

Such language was not unusual in the SDIRA industry. One of the Division's witnesses, Keith Marsh, Chief Operations Officer of SDIRA administrator Specialized IRA Services, and formerly an ETC manager, confirmed that the DOI form used by his present company Specialized IRA Services contains exactly the same language. Marsh testified that this language is "pretty typical" in the SDIRA business. (RX-253; Marsh Tr. 268-71) Placing responsibility for "due diligence" on the customer "[m]eans the IRA holder needs to be comfortable. I mean, they are the ones picking, directing, choosing the investment. We're not picking, choosing, you know, or rating the investment by any means. So it's really the client's responsibility." (Marsh Tr. 269-70)

Immediately below this statement concerning the customer's responsibility on ETC's DOI form, the customer signed and dated the form. Above on the same page, the DOI also provided in greater detail:

> <u>IMPORTANT</u>: Please <u>Ensure That You Read</u> The Following Disclosures <u>Before You Sign</u> And Date These Documents.
>
> 1. Equity Trust Company (Custodian) does <u>not offer any investment advice, nor does it endorse any investment, investment product or investment strategy</u>; and Custodian does not endorse any financial advisor, representative, broker, or other party involved with the investment selected by me. It is <u>my own responsibility to perform proper due diligence</u> with regard to any such representative, financial advisor, broker, or other party. ...
>
> 2. This investment is not FDIC insured and may lose value. In addition the investment selected by the undersigned may lack liquidity; may be speculative and involve a high degree of risk; and may result in a complete loss of the investment. Any loss sustained in my Retirement Account will not affect my retirement income standard. ...
>
> 5. Custodian is acting solely as a passive custodian to hold Retirement Account assets and in no other capacity.... Custodian has no responsibility to question any investment directions given by me....

6. Custodian shall be under no obligation or duty to investigate, analyze, monitor, verify title to or otherwise evaluate any investment contemplated herein.... Custodian shall not be responsible to take any action should there be any default with regard to this investment.

7. It is not the responsibility of Custodian to review the prudence, merits, viability, or suitability of any investment made by me or to determine whether the investment is acceptable under ERISA, the Internal Revenue Code or any other applicable law. ...

11. The undersigned authorizes and directs Custodian to execute and deliver ... any and all documents ... in connection with my investment; and Custodian shall have no responsibility to verify or determine that any such documents are complete, accurate or constitute the documents necessary to comply with this Direction.

12. ... Custodian shall have no duty or obligation to notify the undersigned with respect to any information, knowledge, irregularities or concerns of Custodian relating to my investment or my financial advisor, broker, agent, promoter or representative, except as to civil pleadings or court orders received by Custodian.

13. ... The undersigned understands that Valuations of illiquid assets (assets that are not traded on a public exchange) are generally reported at cost, or values provided to us by issuers, program sponsors, Retirement Account owners or estimates of value. These values are only for guidance or reporting purposes and should not be deemed an accurate representation of true fair market value of the asset. ...

(RX-97-99, p. 4 (emphasis added)

(2) ETC's Custodial Account Agreement. Before signing such DOI forms to direct ETC to make particular investments, customers had to open their SDIRA accounts by completing and signing an application agreeing to the terms of ETC's "IRA Custodial Account Agreement and Disclosure Statement." (OIP ¶13) That custodial account agreement similarly provided (i) that ETC was "acting solely as a passive custodian to hold IRA assets"; (ii) that it was not "a fiduciary ... with respect to your IRA account"; (iii) that ETC did not "endorse any investment, investment product or investment strategy, ... investment advisor, representative, broker, or other party selected by [the customer]"; (iv) that ETC had no obligation to investigate, analyze, monitor or verify title to an investment; (v) that the customer had exclusive responsibility for and control over the IRA assets with "responsibility to perform proper due diligence"; (vi) that ETC had no responsibility to verify or assure completeness of investment documentation; and (vii) that ETC had "no duty or obligation to notify you with respect to any information, knowledge, irregularities or our concerns relating to your investment ... except as to civil pleadings or court orders received by us." (RX-92-96 (emphasis supplied), ¶8.03; cf. RX-90-91).

(3) Customer Supplying Account Documentation. At the hearing, the Division called as a witness Keith Marsh, who is presently the Chief Operating Officer at Specialized IRA Services, an SDIRA administrator, and before that was the Vice President of Operations at Horizon Trust Company, another SDIRA custodian, and who earlier had been an ETC manager. (Marsh Tr. 274) Marsh testified that generally, across the SDIRA custodian industry, "it's the duty of the customer to supply" investment-related documentation to the custodian. (Marsh Tr. 261-62) When the SDIRA held real estate or a note relating to real estate, "[t]he client would" get the deed or security agreement, and it would "eventually" get to the custodian. (Marsh Tr. 284) Even before the customer supplied all documentation, the asset would still be held in the name of the SDIRA custodian for the customer's benefit. (Desich Tr. 990-92)

With respect to obtaining the documentation supporting their chosen investments, ETC stressed to customers that it was their obligation to obtain the documentation and furnish it to ETC. Not only did ETC's custodial account agreement require this, but also it would not be reasonable or feasible to expect ETC to chase after the investment documents of 130,000 customers spread across all 50 states, and pursuing a wide range of self-directed "alternative" investment strategies, many with widely varied forms of documentation and possibly recorded in different ways with unknown depositories. (Desich Tr. 997-98) In this regard, ETC's custodial account agreement with the customer stipulated:

> You authorize and direct us to execute and deliver, on behalf of your IRA, any and all documents delivered to us in connection with your IRA investments; and we shall have no responsibility to verify or determine that any such documents are complete, accurate or constitute the documents necessary to comply with your investment direction.

(RX-92-96, ¶8.05 (emphasis supplied).

In addition, ETC's "onboarding letter" for each investment, advising the customer that the funds had been transmitted as the customer had instructed to make the investment, reminded the customer to supply any missing investment documentation. The letter told the customer to "[p]lease remit the following original documents to Equity Trust Company within sixty days of this letter," and then listed missing documentation for the investment. The onboarding letter also repeated ETC's disclaimer of any duty to police documentation and reminded that it was the customer's job to do this: "It is the IRA owner's responsibility to guarantee delivery of all documents pertaining to your investment(s) to Equity Trust Company. If your investment is backed by collateral and/or is being recorded, please verify with your investment company or the person responsible for securing your collateral that they have performed accordingly to protect your interest." (RX-142, p. 10)

In accordance with the terms of the DOI, ETC disbursed funds as directed by the customer in the DOI, and the disbursement could be before or after the customer's delivery of all of the documentation for the investment. Indeed, ETC understood that for certain investments, such as loans on real estate secured by a mortgage, if a mortgage or deed were intended to be recorded in the county recorder's office, the recorded deed or mortgage, if any, could only become available after the investment was made.

In addition, in situations where customers persisted in failing to provide missing investment documentation, ETC gave them reminders in their quarterly account statements. The account statement listed the particular documentation that was missing and the customer still needed to supply. This list of missing documentation appeared in the "PORTFOLIO POSITIONS" box in each account statement – the most important part of the statement as it listed the customer's holdings – following the words "AWAITING RECEIPT." The quarterly statements also provided the "MATURITY DATE" of promissory notes, so customers receiving statements after the maturity date would be alerted that the maturity date had already passed. And if volume and concentration thresholds triggered a secondary review, as discussed below, ETC would note and consider any missing documentation, and where possible, ETC acting as a volunteer would proceed to ask the sponsor to supply the missing documentation for the customer.

C. ETC's Customer Account Reviews

During the relevant period, ETC was a pioneer in developing reviews of its SDIRA customers' holdings. Michael Dea joined ETC as its President and Chief Financial Officer in August 2008. (Dea Tr. 1568-69) He was a CPA, had a master's degree in finance, and had spent decades in a variety of senior finance positions in the banking industry. In the years leading up to joining ETC, Dea was primarily focused on risk design and mitigation programs in the banking industry. (Dea Tr. 1565-68) When he joined ETC in mid-2008, ETC was already in the process of looking at how it was managing risk. Dea took a leadership role in this effort, and worked with ETC's Governance, Risk and Compliance Committee, composed of ETC's senior management and supported by internal audit, compliance and legal personnel, to develop a new risk monitoring system. (Dea Tr. 1569-71)

This effort included the creation of a report that identified all ETC customers who had a relationship to a particular investment or investment sponsor. The report would show the number of ETC customers in a particular investment and the total amount the clients had invested. Once either the number of customers or the total amount invested exceeded certain thresholds, ETC would conduct what it referred to as a "secondary review" or a "tertiary review" (the different reviews based solely on the total dollars invested or number of investors). In these reviews, ETC's compliance and internal audit staff would review publicly available information about the investment and the sponsor, as well as review individual customer files "to see if they were in good order, see if we had the documentation that we would expect and ... see if it was performing as prescribed." As part of this process, to the extent there were questions, ETC would "reach out to the sponsor ... to see if they could help us gather" any missing information. ETC would also ask the sponsor "a series of questions as to what business were they in, why were they doing what they were doing, what was the goals, how did they attract their customers, what were their marketing materials," etc. (Dea Tr. 1572-75) ETC would do a "secondary" review of the investment and sponsor when the report showed it hit either 20 ETC customers invested or an aggregate of $1 million invested, and would do the "tertiary" review when it reached 75 ETC customers or $5 million total invested. (Dea Tr. 1576-77)

The investment review process described above became operational in 2009 and was, and has continued to be, unique among SDIRA custodians. At the time, ETC "did not believe that anybody else was doing anything like what we were attempting." (Dea Tr. 1576-78; Desich Tr. 968-69, 972) "This wasn't something that was mandated or dictated by law or any regulators." Instead it was something that ETC was "truly doing on our own behalf to better manage risk." (Dea Tr. 1573; Desich Tr. 972-74) ETC was concerned about "its reputation, litigation and financial risk." (Dea Tr. 1578)

As discussed below, following one of ETC's very first secondary reviews with personal involvement by Dea, ETC determined in December 2009 not to accept new investments for ETC customers in entities associated with Ephren Taylor. (Dea Tr. 1579-81) As further discussed below, following secondary reviews in 2010 and 2011, ETC determined not to accept new investment in entities associated with Randy Poulson.

II. FACTS PERTAINING TO EPHREN TAYLOR

Ephren Taylor ("Taylor") was the majority owner and chief executive officer of City Capital Corporation ("City Capital"), a Nevada corporation with its headquarters in Franklin, Tennessee. (RX-6, p. 1) City Capital and its related entities raised funds primarily by issuing promissory notes to investors, including investors who used SDIRA accounts. When investors wanted to use an SDIRA to invest in his entities, Taylor referred them to a number of custodians. Initially, Taylor referred investors to Pensco Trust Company (www.pensco.com) and the Entrust Group (www.theentrustgroup.com) as custodians. During 2008-09, he referred them to ETC as custodian. After ETC ceased opening accounts for Taylor-related investments, he referred them to Sunwest Trust and American Pension Services as custodians. (DX-36, Taylor Dep. 278-83)

A. ETC's Contact With Taylor

(1) ETC As Custodian for Taylor-Related Investments (2008-09). During 2008 and 2009, ETC opened self-directed IRAs for approximately 80 customers who decided to invest approximately $4.3 million in entities affiliated with Taylor and City Capital. ETC received only its standard custodial fees in connection with these custodial accounts. These 80 or so accounts represented an extremely small portion of ETC's business, as it simultaneously acted as custodian for approximately 130,000 other self-directed IRA accounts.

At the outset, ETC assigned Robert Batt ("Batt"), a Retirement Plan Specialist, to open the custodial accounts that were referred by City Capital. (Batt Tr. 294, 304-05) Batt's job was to assist people interested in opening accounts, which often involved educating people on "what they can and can't do inside a self-directed IRA." For example, that under IRS regulations they could not use an SDIRA to buy their own residence, automobiles, rare coins or collectibles. In addition to assisting customers open their accounts, Batt also assisted them in taking the steps needed to transfer their funds into the account once it was opened. For instance, if a transfer was delayed, Batt would check to be sure the paperwork was in good order, and if so he would remind the transferring institution to proceed with the transfer. (Batt Tr. 442-44) In addition to base pay, Batt received $50 for each account opened – regardless whether an investment was ever made in the account. (Batt Tr. 293-94) However once the account was opened and funded, Batt's role ended, and the actual investment process was handled by ETC's Operations Department, a different area at ETC. (Batt Tr. 424; Marsh Tr. 266-67)

Batt joined ETC in 2008, and his credentials included BS and MBA degrees in finance and Series 7 and 63 licenses as a former Fidelity broker. (Batt Tr. 288-89) upon joining ETC, Batt underwent six to eight weeks of off-site training in a classroom setting, including "intense training" about retirement plans and what can and cannot be done inside an SDIRA. (Batt Tr. 296-97; Marsh Tr. 196-97) His training also included instruction on the role played by ETC as a "passive" custodian, and the concept that ETC and its employees would not endorse any investment and "could never endorse a sponsor." (Batt Tr. 299-303; Marsh Tr. 196, 209-10) Batt was trained that, when attending outside events, "we could never endorse a sponsor, so if [event attendees] ever had a question about ... a sponsor, we would just go, oh, they're over there at that table, that's a good question for them." (Batt Tr. 303) Batt's manager Keith Marsh confirmed that ETC's multi-week training was "pretty in-depth" and included presentations by ETC's top management. (Marsh Tr. 265-66)

Like any other salesperson, Batt sought referrals of individuals who might open custodial accounts at ETC. ETC staff called sources providing such referrals "centers of influence" or "COIs." (Batt Tr. 293; Marsh Tr. 210) During his three years at ETC, Batt dealt with approximately 100 COIs and "hundreds of investment sponsors." (Batt Tr. 294-95, 469-70) As a COI, Taylor was a "low" source of referrals for Batt. (Batt Tr. 446-47) Batt had other referral sources that were considerably bigger, for example the best-selling author, financial literacy educator and entrepreneur Robert Kiyosaki. (Batt Tr. 487) Batt treated Taylor no differently from other referral sources. (Batt Tr. 296, 307-08)

Batt's supervisor Keith Marsh testified that he did not recall Batt ever recommending or endorsing an investment sponsor. (Marsh Tr. 257; Desich Tr. 981-83) Marsh periodically monitored the phone calls of the sales representatives reporting to him, including Batt. The reps knew that their calls would be monitored, but would not know when those calls were being monitored. (Marsh Tr. 211-14, 259-60)

(2) Batt's Updates to City Capital. Batt provided City Capital personnel with status updates on custodial customers who were directing ETC to transfer funds to City Capital or one of its related entities, including whether the custodial accounts were open, the timing of any transfer of funds into the custodial account, and the completion of any such transfer. (Batt Tr. 449-52) These were not advertisements of available cash for a promoter to pounce upon, as the Division has suggested. To the contrary, these were updates on customers who had recently been referred to ETC by City Capital and who were already in the process of investing in one of the City Capital-related entities. (Batt Tr. 309-10, 452-54)

In providing these updates, Batt acted appropriately. Before providing the customer information, Batt made sure that City Capital's staff provided him with the customer's "PIN" number that authorized them to obtain the information concerning opening and funding of the customer's account. Batt repeatedly told the Division's counsel that he obtained PIN numbers before providing information. (Batt Tr. 306-07, 310-14, 345, 450-53) Batt's manager Keith Marsh also testified that general account information, including balances, could be shared with anyone having the PIN number. (Marsh Tr. 263-64) The Division has not presented contrary evidence.

Even if Batt had not been careful to obtain customer PIN numbers in this fashion, his conversations and emails with City Capital concerning the status of account opening and fund transfers would still have been permissible because they were the kinds of communications with third parties specifically allowed by ETC's privacy policy. (Batt Tr. 437-39) ETC's privacy policy expressly allowed it to communicate appropriate customer information with third parties as part of carrying out the customer's intended transactions. The policy provided that ETC could disclose customer information, among other things: (i) "In the course of business to administer, enforce, or effect a transaction requested or authorized by the consumer"; (ii) "To service or process a financial product or service requested or authorized by the consumer"; or (iii) "To carry out a transaction or product or service the business of which the transaction is a part, and record, service, or maintain the consumer's account in the ordinary course of providing the financial service or product." (DX-46, exh. p. 14, orig. p. 12)

Such a privacy policy was reasonable and designed to help ETC service the investment desires of its customers. Here customers were opening accounts and signing ETC's account application for the express and pre-determined purpose of investing with City Capital or one of its related entities. To that end, each customer furnished ETC with the necessary information so that ETC could accept the transfer of funds held by the customer's previous retirement account custodian. The customer then would send in the signed DOI instructing ETC to disburse the funds to City Capital. With the customer's entire account opening and funding intended for the purpose of a City Capital investment, it was consistent with ETC's privacy policy for the ETC account-opening representative to communicate with City Capital – in informal email or phone communications – concerning the permitted topics permitted by the privacy policy, *i.e.* the status of the funds transfer "in the course of business to administer ... or effect," or "to service or process," or "to carry out" the transaction its customer was requesting with City Capital. (Batt Tr. 453-54; DX-46, exh. p. 14, orig. p. 12) Batt's manager Keith Marsh, called by the Division, confirmed this in his testimony:

> If the investment sponsor was working together with the client on an investment, they would, I believe, provide like the transfer hasn't arrived yet or the funds haven't cleared yet, you know, those general bits of information, if the two parties were working together. You know, oftentimes the client would open an account with us and they are choosing to invest with the sponsor so they're kind of working together, so in that circumstance – and so they would review just balance information primarily. ... [T]he sales team would provide general information at times, that the transfer hasn't arrived yet or maybe a dollar amount or when it's going to clear ... – that was the information they would provide.

(Marsh Tr. 222-23)

B. Taylor's Public Profile and EDGAR Disclosures

(1) Taylor's National Prominence. People, including ETC customers, invested with Taylor based on his prominent national profile and their identification with his Christian background as he roved the country on his "Wealth Builder Tour." (RX-27 to 31, 36, 37; DX-36, Taylor Dep. 220-222) On August 25, 2008, the Democratic National Convention presented Taylor as a speaker on "socially conscious investment." (RX-25, 227; Davis Tr. 1675-76) Megachurches and smaller congregations presented and endorsed Taylor to their members. In late June 2009 – in the middle of a particularly relevant period in this case – the National Conference on Volunteering, opened by First Lady Michelle Obama, featured Taylor with the

CEOs of eBay and KPMG on a "Business Leaders for Change" panel moderated by CNN analyst and Harvard professor David Gergen. (RX-24, 228; Davis Tr. 1681-82)

Major media outlets uniformly profiled Taylor in a strongly positive and attractive light, including news reports and personal interviews on ABC, CNN, Forbes, and NPR, all of which uniformly and effusively trumpeted Taylor's business success to their national audiences. (RX-241, 30, 31, 36, 84, 85; Davis Tr. 1681) Among these major media appearances, Taylor was interviewed on ABC News' long-running "20/20" newsmagazine show, appeared twice on the Montel Williams Show, appeared on CNBC's "The Big Idea" with Donny Deutsch, the nationally-syndicated Tom Joyner Morning Show, and Fox News' "Your World" with Neil Cavuto, and was a regular weekly panelist on Bulls & Bears on Fox News. (DX-36, Taylor Dep. 209-13) Media outlets reached out to Taylor directly to have him appear. (Davis Tr. 1681)

Building on the endorsements he received from numerous media, business and religious leaders, Taylor publicized himself as a highly successful business person focused on small, community-oriented businesses. Taylor's 2008 book, "Creating Success From the Inside Out," appeared twice on the Wall Street Journal's best-seller list and was published by the 200-year old Wiley & Co., and was followed by his 2009 book "A Lead Entrepreneur." (Davis Tr. 1677-79) Investors were attracted by Taylor's multiple 30-minute television infomercials on Fox, Black Entertainment Television, The Word Christian network, and other outlets. (Taylor Dep. 205-08) He marketed himself and his investments over several years, at least from 2006 through 2010, through a series of traveling seminars and other events that he referred to as his "Wealth Builder Tour" or "Wealth Builder Network." Taylor's mantra in his addresses to prospective investors and others was, "Let's make money together." Other than attending a single church event in October 2009, ETC never appeared at any of these Taylor "tour" events. (DX-36, Taylor Dep. 217; Batt Tr. 454, 459-60)

Taylor worked five years, from 2006 until 2011, with the "branding and public relations" firm of Ascendent Strategies, headed by Raoul Davis. (Davis Tr. 1672-73) Taylor was "positioned" as "the youngest black CEO of a publicly traded company," and Davis began by booking Taylor at a Congressional Black Caucus event in 2006. (Davis Tr. 1674) Over the ensuing years, Davis proceeded to book him to speak at probably 40 to 50 events, before media outlets, government bodies, universities (including Harvard and the University of Chicago), churches and other organizations, many with national reach such as the National Urban League, the NAACP and the YMCA. (Davis Tr. 1676-77, 1679-81, 1688-89)

As part of his public relations work for Taylor, Davis met with him "between 30 and 50" times in person, spoke by phone "several times every month," and routinely exchanged emails. (Davis Tr. 1683) He viewed Taylor as "an optimistic, nerdy kid from Kansas who was socially conscious, looked like he was changing the world, was very inspirational." Davis recalled a

Southern Christian Leadership Conference event where "a gentleman who worked with Dr. King gave [Taylor] a photo of himself with Dr. King and said, you can be the next great ... civil rights leader in terms of economic empowerment," and Davis added "that was kind of what many of us working with [Taylor] ... thought he could be." (Davis Tr. 1683-84) In 2009, Davis saw Taylor's public SEC filings for City Capital, described immediately below, and observed that the company was in debt but still issuing promissory notes. But he accepted Taylor's explanation that "he was turning the company around" and "gave him the benefit of the doubt." (Davis Tr. 1690-92) And in mid-2010, Davis arranged for his then-new spouse to invest some of her own retirement funds with Taylor, using Sunwest Trust as SDIRA custodian, as by then ETC was no longer accepting new investors with Taylor. (Davis Tr. 1673-75, 1686, 1699)

(2) Taylor's Public Disclosures on EDGAR. While its securities were not registered under Securities Exchange Act §12, City Capital was subject to the periodic reporting requirements of §15(d). Throughout the relevant period, it filed annual reports on Form 10-K and quarterly reports on Form 10-Q – all publicly available on EDGAR at sec.gov. And its financial statements – contained in these periodic reports – were accurate, were prepared by an outside certified public accountant who had direct access to City Capital's books and records, and were audited by an independent public accounting firm. (Keeton-Cardno Tr. 1721-22; DX-36, Taylor Dep. 229-32, 269-78) Lynda Keeton-Cardno, the experienced outside accountant who personally prepared City Capital's statements, testified at the hearing that "[e]ven as of today, I've had nothing come to my attention that would indicate that the information [in the annual report] is incorrect." (Keeton-Cardno Tr. 1722) The Division has not challenged the accuracy of this statement.

Ms. Keeton-Cardno, an Arthur Andersen-trained CPA registered with the PCAOB and the AICPA, described the rigor she brought to City Capital's financial reporting. Each quarter, she obtained an electronic copy of its financial records and demanded to see relevant backup documentation, including signed copies of notes. (Keeton-Cardno Tr. 1709-10, 1713-16, 1720) After she had "scrubbed everything and written the [draft reporting] document, that's when we would publish to the external auditor," the Spector Wong CPA firm, which would then perform an independent audit of City Capital each year. (Keeton-Cardno Tr. 1721-22)

Each year during the relevant period, City Capital's public disclosures specifically acknowledged (i) that it was significantly in debt; (ii) that it had notes coming due to earlier investors; (iii) that it was still losing money; and (iv) that its funding was continuing to come from the new promissory notes it was selling. It also particularly itemized each year its growing number of outstanding promissory notes by principal amount, interest rate and maturity date as part of its financial statements in its annual reports. Among other things, its 2008 Form 10-K annual report – filed on May 20, 2009, and thus the disclosure document "live" during most of the relevant period in this case – stated that:

- Its "independent registered public accounting firm expressed substantial doubt about the Company's ability to continue as a going concern ... as a result of cash flow constraint, an accumulated deficit of $12,152,194 ... and recurring losses from operations." And its net losses were continuing. (RX-2, pp. 8-9)

- Its ability to remain in business depended on "obtaining additional funding from the sale of its securities," and its itemized outstanding notes had nearly doubled from a total of $1,980,008 payable at year-end 2007 to $3,777,556 at year-end 2008. (RX-2, p. 63)

- It had identified "material weaknesses in ... internal control over financial reporting and determined that [it] did not maintain effective internal control over financial reporting." (RX-2, p. 11)

Similar disclosures to these also appeared in Capital City's earlier-filed 2007 Form 10-KSB, filed May 1, 2008 (DX-537), and in its later-filed 2008 Form 10-K/A, filed September 8, 2009 (RX-6), and its 2009 Form 10-K, filed June 15, 2010 (RX-1). Financial information and disclosures concerning City Capital's ongoing losses, accumulated deficit and other financial and business challenges similarly appeared in its Form 10-Q quarterly reports, and in other disclosures. As SEC filings, these disclosure documents were available in real time on the SEC's EDGAR system, the core tool used by the public to evaluate prospective investments.

In considering this still-young company's performance and condition, its outside accountant Ms. Keeton-Cardno commented that "this was a business that was attempting to do very good things in inner city cultures. When I look at a business like this with my background, at some point I think they could have succeeded if they had economies of scale." (Keeton-Cardno Tr. 1723) It was not until 2010, after ETC stopped accepting new investments with Taylor, that her opinion of City Capital's viability changed. By that time, she believed that Taylor "was really backing away from the company," and she "couldn't get information" she needed. (Keeton-Cardno Tr. 1727-28)

C. No Endorsement of Taylor

(1) [redacted] Hill's Investment (June 2008). The Division presented testimony from [redacted] Hill, who was one of the earliest to invest with Taylor using ETC as his SDIRA custodian. Hill recounted how the Reverend Willie B. Jackson, for 20 years the senior pastor at his church, invited Taylor to speak to the congregation to help with their finances. The church was Westside Church of Christ in Jacksonville, Florida, where Hill was a deacon and had been a member for over 30 years. Pastor Jackson told Hill that Taylor "was a young, successful millionaire and that he was a member of" the Church of Christ denomination. (Hill Tr. 166-69, 177-79) It was important to Hill that Taylor was "a Christian guy." (Hill Tr. 175)

Taylor was at Hill's church for a week and held a series of meetings with the deacons and the congregation. (Hill Tr. 179) ETC never attended any of the events at this church. Hill met personally with Taylor and one of his associates, and they proposed an investment program to Hill that would give him a 10% return. (Hill Tr. 170-71, 184-85) Hill testified that he then had a "quick call" of about one minute in duration with Batt at ETC, who said simply that "it's a good company and he's getting people right now 10 percent return." Apart from this one-minute phone call, Hill testified that he never spoke again with Batt or anyone else from ETC. (Hill Tr. 172, 186-87, 191) As for the one-minute call itself, Hill testified he "won't say [it was] an okay from Equity Trust." (Hill Tr. 175) And in his DOI form directing an unsecured loan from his SDIRA to City Capital, Hill specified immediately above his signature that ETC did not recommend the investment; that he was responsible for "selection, due diligence, management, review and retention" of the investment; and that ETC was not acting as his fiduciary. (RX-135; Hill Tr. 187-91)

When Hill's note matured after a year, Taylor paid to fly Hill and his spouse to Raleigh for the weekend to visit City Capital's offices, after which Hill not only agreed to renew his maturing note but also to add funds to the principal he was loaning. (Hill Tr. 192-93) Hill has a high school degree, and his spouse is a collection agent for the IRS. (Hill Tr. 165-66)

(2) [redacted] Dorio's Investment (January 2009). [redacted] Dorio and her family were apparently Taylor's biggest investors. Taylor testified at some length regarding the process he used to recruit Dorio to invest, including through several direct personal presentations by Taylor and his associates. Dorio first saw Taylor during a presentation he made at her mega-church, Pastor Joel Osteen's Lakewood Church in Houston. (DX-36, Taylor Dep. 185-86; Dorio Tr. 794-95) That presentation at Lakewood– with 45,000 members, reportedly the largest congregation in the country – was attended by hundreds of church volunteers. (Dorio Tr. 795-96, 831) In addition to describing his personal business achievements and showing a video of himself being interviewed on major news programs, Taylor identified himself as the son of a church pastor and preached to the Lakewood group from the gospels. Taylor told Dorio and the other church members present that, unlike mutual funds which were investing in various sinful enterprises, his investment program would create jobs for young church members. This was important to Dorio. (Dorio Tr. 796-97, 833-35) Dorio had been a member of the church for eight years, and had been promoted up in the usher ministry to the rank of service leader. (Dorio Tr. 795-96) She was "very active" in church activities. The church had a "substantial" place in her life, and "most" of her friends were from the church. (Dorio Tr. 830-31)

Dorio was relatively sophisticated as an investor. She had a bachelors degree in business, which included courses in accounting, finance and business law. Her law course included contracts. At the time of her investment with Taylor, she worked in the accounting department of a health staffing company, with responsibility for handling invoices and payroll. Previously she had worked for 13 years handling administrative, payroll and financial responsibilities at another company. (Dorio Tr. 826-28)

In addition to making her own investments, Dorio also had a power of attorney authorizing her to make investment decisions for her mother, Virginia Wallace, whose pre-Taylor investment portfolio, held at AIG Financial Advisors, already included a significant investment in two untraded real estate investment trusts (REITs), and there was an additional $1.3 million available to possibly invest with Taylor. (Dorio Tr. 793-94, 829-30, 889) Dorio also had a personal investment adviser, Robert Wheeler at AIG, with whom she spoke quarterly and who had been recommended by her family lawyer. (Dorio Tr. 816-17, 852-53)

Following Taylor's presentation at Lakewood Church, Dorio contacted [redacted]ne of Taylor's colleagues and revealed to him the amount she had to invest – essentially $1.3 million from her mother's account and approximately $20,000 from her own account. (Dorio Tr. 798) Dorio felt that Taylor's proposed investments were similar to the REITs her mother's account already owned through AIG, but she believed Taylor's investments "were different in that they were helping people also." (Dorio Tr. 854)

After this initial phone conversation, Taylor and his two sales deputies, Chris Lewis and Anthony Hall, flew back to Houston to meet personally with Dorio and her husband. Taylor's team also included an individual who Taylor described as a retired tech executive to vouch for Taylor and tell the Dorios that he had succeeded with Taylor's investments. (Taylor Dep. 184-86; Dorio Tr. 798-99, 836-39) Taylor testified that he, Lewis and Hall then met again personally with Dorio in New York and Kansas City to propose investments, and Dorio recalled another meeting with Taylor in Houston. And Taylor and Dorio both testified that "during the sales process, [Taylor and his associates] probably talked to her several times a week" by phone for "over a month." (Taylor Dep. 187-89, 191-92, Dorio Tr. 839-43)

ETC did not attend Taylor's Lakewood Church event, nor did it participate in any of Taylor's follow-up personal meetings with Dorio. Taylor introduced Robert Batt of ETC as an SDIRA custodian to Dorio in a conference call. (Dorio Tr. 799-800) Dorio had "two or three" phone conversations with Batt. (Dorio Tr. 856) Dorio understood that ETC would act as a custodian. (Dorio Tr. 800) Dorio already knew what custodians did from previous exposure to three different SDIRA custodians. *First*, as president of the Houston chapter of the American Cash Flow Association, she learned how SDIRA custodian Pensco Trust Company could be used to fund businesses through an IRA. (Dorio Tr. 843-47) *Second*, the REITs that she continued to keep in her mother's account at AIG were being held by another SDIRA custodian, Sterling Trust Company. She knew that, as SDIRA custodian, Sterling was simply "the records keeper" that sent her periodic statements. (Dorio Tr. 849-51) *Third*, the additional $1.3 million of her mother's funds that she was thinking about investing with Taylor were already being held by still another SDIRA custodian, SunAmerica Trust Company. (RX-232)

By early January 2009, and after months of personal visits by Taylor and his sales team and phone conversations several times a week, Dorio had determined to invest the available funds she managed for her mother as well as her own relatively smaller amount with Taylor. In order to make these investments using ETC as her custodian, she directed that the investment process commence. On January 7, Batt informed Taylor that AIG had "put the sell (Wallace/Dorio) orders in." (DX-278, 279) Dorio's requested fund transfer, however, ran into resistance from Robert Wheeler, the AIG investment adviser for the account from which the funds would be transferred. On January 8, Wheeler wrote Dorio a letter, as follows (DX-830):

> I am sorry to see you move most of your assets away to do more "private placements" – the things you refer to as items that you can "see, feel and touch". (By the way this is a very clever marketing concept for these items, and will use it myself in the future.)
>
> As you must know, I do believe in these types of investments or I would not have sold you the Cole and Inland REITS. And, you may wonder why, if they are so good, why I did not just diversify you into more of these types of programs. Please understand that these programs are NOT without risk – especially if the economy continues to slow and the recession continues for some time. ...
>
> [redacted] I care for you and your mom. I know you are a Christian and have prayed over this. So have I. Rather than just let you go, I feel I have been directed to ensure you have a full understanding of the all-encompassing risks as well as the benefits of what you may be getting into. ...

Less than a week later, Dorio sent an email to Taylor's principal sales deputy Chris Lewis, with the subject heading "Getting into Wallace Accounts." In her email, Dorio gave Lewis the account number, and the secure username and password, for her mother's AIG account held at SunAmerica Trust Company, as well as for another smaller Wallace account. Dorio concluded her message to Taylor's colleague Lewis with the following:

> "Let me know if there's anything else you need or want. We have the victory and nothing else will hinder or delay this coming to pass." (RX-232)

Dorio testified that, at the time she wrote this email giving her AIG account password to Lewis at City Capital, she was firmly committed to investing with Taylor. (Dorio Tr. 859-61)

Dorio also copied this email to ETC's Robert Batt with a request that, "when the transfer is complete, please give me the total amount transferred from AIG." Batt briefly replied that he would "follow up" with her "next week." (RX-232) Later the same day, Batt sent an email to Taylor that read in its entirety as follows:

> I did a conference call with [redacted] today and it was a good call. The broker at AIG blocked the transfer and sent [redacted] Dorio a letter. The letter basically trashed commercial real estate and said don't transfer out ... "you will regret it". It was so cheesy it sounded like a 1st grader wrote it. I said "[redacted] ... how can you comment on something you know nothing about ... how can this broker comment on real estate when he has never done it". She said "great point" lets do it ... we called the brokers PA/trading assistant ... they sold one bond (hence why transfer was rejected ... they did not sell everything) and the wire to us will go out Monday or Tuesday of next week ... I am on it ... I will close it .... Thanks for your business." [ellipses in original] (DX-14)

The foregoing sequence of events demonstrates that it was Taylor, Lewis and others at City Capital who sold Dorio on this investment, not Batt. The timing of these emails, and the events they reference, further show that Dorio had firmly made up her mind and set in motion the steps to invest with Taylor at a point well before Batt – then engaged in the mechanics of the account transfer – emailed that he would "close it." By "close it," Batt meant simply that he would "get money into the IRA" by completing the transfer of funds that had been requested by Dorio (Batt Tr. 479), a transfer that Dorio had directed at least a week earlier – when the AIG sell orders were placed on January 7 – and on which Dorio was expecting Batt to report during the "next week," as discussed above.

In the DOI forms for these investments (RX-151, 181), Dorio acknowledged that: (1) "Equity Trust Company has not solicited, recommended or sold this investment to the retirement account owner." (2) "Equity Trust Company does not endorse this investment." (3) "My retirement account is self-directed and I, alone, am responsible for the selection, due diligence, management, review and retention of all investments in my account." (4) "I agree that the custodian is not a fiduciary for my account." (5) "Equity Trust Company (custodian) does not offer any investment advice, nor does it endorse any investment, investment product or investment strategy; and custodian does not endorse any financial advisor, representative, broker, or other party involved with an investment selected by me." (Dorio Tr. 866-68, 881-82; RX-151, 181) Indeed, when pressed by the Division on why ETC's involvement as SDIRA custodian would have given her any "comfort" in investing with Taylor, all Dorio could say was that ETC "is a large corporation." (Dorio Tr. 800-01)

(3) Batt's Training Session at City Capital (June 2009). In June 2009, Batt traveled to City Capital's offices in Raleigh in order "to educate [its staff] more about IRAs and how people can save more inside IRAs because they don't pay taxes." Batt conducted two 2-hour training sessions, using "the generic slides that everybody [at ETC] used," for approximately ten City Capital employees. He did not give instruction on how to fill out ETC's forms. (Batt Tr. 417-18) This was the only time Batt or any ETC personnel ever actually visited any City Capital office. Taylor was not present during Batt's visit. (Batt Tr. 471-72) Batt's manager Keith Marsh, called by the Division, testified that Batt visited City Capital "to educate or train .. staff members that they hired that wanted to know ... more about the self-directed IRA," and he saw nothing out-of-line or improper about Batt doing this. (Marsh Tr. 264-65)

(4) [redacted] Sims' Investment (August 2009). Sims was first introduced to fellow-Kansan Taylor when she saw him speaking on a national Christian television network about using self-directed IRA accounts to engage in "socially conscious" investment programs that would help improve the community. (Sims Tr. 1427-28) Sims was attracted by the concept of investing in community improvement, and subsequently went on to obtain Taylor's books "The Three Simple Steps to Multiply Your Retirement Income," and "Creating Success From the Inside Out." (Sims Tr. 1398-1401, 1429-32)

She has a BS in business management, and her college education included courses in accounting, finance and investments. (Sims Tr. 1398, 1423) After working in the banking industry for approximately three years, Sims moved on to a [redacted]-year career working as an analyst at Boeing and thereafter as a buyer at another aerospace company, a position which required her to be familiar with contracts. (Sims Tr. 1423-24, 1450-52) Sims researched Taylor and City Capital online using Google and the Better Business Bureau website (which turned up nothing negative about Taylor or City Capital), and read about Taylor having been a millionaire at a young age and the CEO of City Capital. (Sims Tr. 1432-34) She also researched various SDIRA custodians online, and she noted that while Taylor's book mentioned ETC, its custodial fees were higher than some other SDIRA custodians. (Sims Tr. 1435-36) After hearing Taylor on television and reading his books, Sims decided that she "wanted to invest with the self-directed IRA account," whereupon she called City Capital and spoke with Taylor's associate Shelton Jones, who discussed Taylor's community investment program with her. (Sims Tr. 1402, 1431)

Jones told her that "clients set up their accounts with Equity Trust" and provided her with Batt's contact information. Sims then called Batt to open an SDIRA account into which she subsequently transferred $150,000. (Sims Tr. 1402-05) However Sims only invested $50,000 with Taylor, and she later transferred the remaining cash balance of about $100,000 out of her ETC account and back into her employer's 401(k) plan. (Sims Tr. 1440-41) Her DOI form directed ETC to deliver $50,000 to City Capital for a secured loan of $50,000. Sims understood that the DOI would "give [ETC] permission to take the money from the account. That's what I understood." (Sims Tr. 1443) The DOI indicated that "the company" would serve as the collateral for the loan which Sims understood meant that "if anything happened, you now, and for – [City Capital] would be responsible for, you know, paying the money back." (Sims Tr. 1445) In this respect, the obligation reflected in the DOI form she signed was identical to City Capital's undertaking in its promissory note, which she also signed as the counterparty. (Sims Tr. 1407-08, 1442-47) Her DOI form specified above her signature that ETC did not recommend the investment, that she was responsible for "selection, due diligence, management, review and retention" of the investment, and that ETC was not a fiduciary. (RX-168; Sims Tr. 1445)

(5) Possible "Landing Page" (Fall 2009). At some point during the last four months that ETC accepted new accounts from Taylor investors – *i.e.* the period between August and December 2009 – ETC prepared a so-called "landing page," designed as a possible sub-page on the ETC public website, with respect to "City Capital Corporation – Wealth Builder Network." If the page ever went live on ETC's website, individuals considering an investment with City Capital could visit the page to download linked SDIRA account opening and DOI forms and click on links to other pages on the ETC website referencing the permissible and prohibited uses of IRA accounts. (DX-576)

The Division, however, has not carried its burden of establishing whether this "landing page" was ever actually made available to the public, and if it was, for what portion of these final four months. Robert Batt, the ETC employee responsible for opening new SDIRA accounts investing in City Capital, consistently testified that the landing page never went live. Batt testified that he and other sales people were told that the landing pages for City Capital and other investment sponsors were merely in "beta" or testing phase, and ultimately were told that they would never go live. Batt confirmed that he never opened a single new account as a result of a landing page, and that other ETC sales persons similarly did not obtain new accounts using the proposed landing pages. (Batt Tr. 379-386, 391-92, 395-96, 399-400, 416-17, 436, 486) In the face of Batt's repeated and consistent testimony – that the landing page never went live – the Division did not call any actual or potential investors who said they actually read or even saw the landing page live on ETC's website.

The limited documentary evidence on the landing page's "live status" is inconclusive. Batt's August 14, 2009 email to City Capital personnel said that the page was "live" at a particular direct link provided in the email, and asked for City Capital's reaction after looking at the page, without indicating whether it was yet available on ETC's public website for use by people who did not have the direct link to the particular page. Two months later, however, Batt was still communicating with ETC's technical staff about the content that would go into the landing page, thus suggesting that the page was still not finalized in October. (DX-338, 360; Batt Tr. 434-35) As a result of the lack of clear and convincing evidence regarding the "live status" of this landing page, ETC filed an Amended Answer in this proceeding stating in paragraph 37 that "ETC has been unable to determine whether this landing page went live on the Internet and, if so, whether there were any visits to this landing page prior to the time ETC stopped doing business with Taylor." If the page actually had gone live, its maximum functional lifespan would have been four months or less, as ETC put Taylor on "hold" status on December 23, 2009 (DX-534, p. 2).

Whether the landing page went live or not, an examination of the page itself shows that it did not endorse City Capital or Taylor. Indeed, other than the reference to "City Capital Corporation" at the top of the page, there was not even a single mention of City Capital, Taylor, or their proposed investments anywhere on the page. Apart from links to ETC's account opening forms and to other pages on ETC's website referencing possible and prohibited uses of SDIRAs, the so-called landing page contained only two substantive text paragraphs. The first paragraph was simply a welcome that resembled other landing pages prepared for ETC's website – with no unique or different treatment for City Capital, and certainly no recommendation or endorsement of investments in City Capital – and that read as follows (DX-576):

> Welcome to the personalized Equity Trust Company page for members of the Wealth Builder Network. We're pleased to provide you with the support to grow your business and, in turn, help you grow your wealth. One way to invest in real estate is through a Self-Directed IRA, which allows you to maintain your liquidity and invest to build your wealth. With the help of Equity Trust Company, you can self-direct your IRA to invest in real estate, as well as other options. On this page, you will find links and key points about real estate IRAs – including overviews, types of real estate your IRA can purchase and guidelines for investing in real estate through a self-directed IRA. Below are the documents you need to get started. All you need to do is complete the Application, Transfer Form and Equity Investment Form. The term 'real estate IRA' encompasses any type of real estate investment in a self-directed IRA or 401(k). We've created a special checklist to ensure that you submit the proper forms and provide all documents necessary to open an account.

This welcome paragraph references investing in real estate not promissory notes, let alone, City Capital notes. Indeed, its language is copied verbatim or in substance from other ETC "landing pages" that are included in the Division's landing page exhibit. (DX-576) At the hearing, Batt compared this welcome paragraph with another landing page prepared for a different organization and found the language of the two to be completely identical. (Batt Tr. 429-433)

The second substantive paragraph of the landing page was a "Disclaimer" stating that ETC (1) was a passive custodian, (2) did "not endorse or recommend" any investment, (3) did not provide investment advice, and (4) advised prospective customers to consult others on investment decisions. The exact language is as follows:

> Disclaimer: Equity Trust is a passive custodian and does not provide tax, legal, or investment advice. It does not endorse or recommend any contributor, company, or specific investments. Any information communicated by Equity Trust Company is for educational purposes only and should not be construed as tax, legal, or investment advice. Whenever making an investment decision, please consult with your legal, tax, and accounting professionals. The Wealth Builder Network educational discount applies to new educational program enrollments only and is not valid for already discounted programs.

(DX-576, emphasis added) Thus, even if this landing page actually went live and actually received any visits, a prospective customer would have seen ETC's disclaimer of investment recommendations by ETC and no endorsement or other recommendation of Taylor. Likewise, any standard ETC account opening forms downloaded from the landing page would also have included ETC's disclaimer of investment recommendations, as discussed above.

(6) Event at New Birth Church (October 2009). The first and only time anybody from ETC met Taylor was when Robert Batt met him at an evening event held just two months before ETC stopped accepting new accounts that planned to invest with Taylor. The total amount of time Batt spent actually speaking with him at this event was "between five to 10 minutes." (DX-36, Taylor Dep. 302; Batt Tr. 454, 457-59) The event was held on October 20, 2009 and was part of a multi-day event sponsored by an Atlanta mega-church, New Birth Missionary Baptist Church, and at which the Church's spiritual leader, Bishop Eddie Long, warmly introduced Taylor as "my friend, my brother, the great Ephren Taylor." Literally two months later, on December 23, 2009, ETC advised Taylor that it would not take new accounts from his investors. (DX-534, p. 2)

By the time of the New Birth event, Taylor had already spoken at hundreds of similar events, including dozens of churches around the country. Taylor realized that it was "significantly influential" to his scheme that the churches were vouching for him. (DX-36, Taylor Dep. 213-217) Taylor never asked ETC to attend, nor, in fact, did anyone from ETC ever attend, any of these many church and other events. (Taylor Dep. 217; Batt Tr. 454, 459-60) This is inconsistent with the Division's position that Taylor was using ETC to gain credibility with his church audiences. It is clear that Taylor did not need an Ohio-based IRA custodian that nobody present had ever heard of to gain credibility with his New Birth audience. Indeed, Taylor acknowledged that his investors would never have heard of Pensco or Entrust (the two custodians Taylor used before Equity Trust), Equity Trust, or Sunwest Trust or American Pension Services (the two custodians Taylor used after Equity Trust stopped accepting new business from him two months later). (DX-36, Taylor Dep. 278-83)

New Birth Missionary Baptist Church, the mega-church hosting the October 2009 event, had grown from 300 members in the mid-1980s to over 25,000 members by 2009, all under the leadership of its pastor, Bishop Eddie Long. The church had achieved considerable notoriety by conducting the funeral of Coretta Scott King, a service attended by President Bush, future President Obama, and former Presidents Carter, Bush and Clinton. Coretta Scott King and Dr. Martin Luther King, Jr.'s daughter, Bernice King, was one of the New Birth Church's elders. (Wells Tr. 40-41; Turner Tr. 1375)

New Birth publicized the Taylor event for a couple of weeks in advance using radio advertisements, banners and a glossy handout featuring photos of both Taylor and Bishop Long. (RX-243; Wells Tr. 45-47; Jones Tr. 99; Turner Tr. 1348-49) New Birth hosted Taylor over at least five different sessions – a youth meeting (RX-230) and men's group meeting on Saturday, two worship services on Sunday, and an evening seminar attended by thousands on Tuesday evening. The church also made available conference rooms in "the executive offices that ... the church leadership uses" for Taylor's staff to conduct one-on-one meetings with potential investors from the congregation. (Wells Tr. 47-48; Jones Tr. 138; Turner Tr. 1379)

At the two Sunday worship services, Bishop Long introduced Taylor to the congregation as an ordained minister and the son of a pastor, reinforcing his credibility. As he began to speak, Taylor pointed out his father and mother in the audience and asked them stand up to be recognized by the audience. Bishop Long described Taylor as a "man of God" and someone "very experienced." He said that Taylor, the CEO of a publicly-held corporation, could help the congregation in their financial matters and encouraged them to come to Taylor's presentation on Tuesday. (Wells Tr. 49-50; Jones Tr. 134-35; Turner Tr. 1349, 1381, 1384-85) During the Sunday service, Taylor showed a video about the collapse of Wall Street, and spoke about urban revitalization and rebuilding communities. (Jones Tr. 135-36)

The Tuesday evening event began with a video showing Taylor being interviewed on several national news programs. (RX-35; Wells Tr. 57-58, 60-61) Bishop Long then took the stage to introduce Taylor as a "man of God" and an ordained minister. (Wells Tr. 60) Both Bishop Long and Florida pastor Rev. Delatorro McNeal endorsed Taylor from the church's stage. (Turner Tr. 1350, 1382) Taylor has testified that Bishop Long's introduction gave Taylor "significant" credibility in addressing the Bishop's church audience, which numbered about 10,000 people, and Taylor had his "sales staff and team" there to personally pitch investments in City Capital. (DX-36, Taylor Dep. 292-95, 301-02)

After these glowing introductions, Taylor took the stage to address the congregation about investing in real estate, clean energy and small businesses, including through the use of self-directed IRA accounts. Taylor told the congregation that large mutual funds "are investing in brothels, like Hooter's, bars and different places like that and that we need to be more vigilant in investing our money in places that we want it to go as far as being Christians." (Turner Tr. 1351) Otherwise, Taylor's investment-related remarks were general in nature and Taylor did not market City Capital notes or any other specific investment during the Tuesday evening program. (Wells Tr. 61-63; Turner Tr. 1351)

As previously noted, ETC retirement plan specialist Robert Batt was in the audience at the Tuesday evening program. During his lengthy presentation, Taylor pointed Batt out and asked him to stand up in the audience to be recognized. With the glare of the church's television lights in his eyes so that "couldn't see a thing," Batt stood up at his seat with a deer-in-the-headlights frozen expression and waved. The following – lasting about a minute out of a 2-1/2 hour program that was one of five Taylor programs at New Birth that week – is a verbatim transcript of everything Taylor said about Batt and Equity Trust:

> And so the thing is that I have a special – I have several special guests in the audience today. One is Mr. Robert Batt, if you could stand up. He is actually my banker. ... Yeah – like, yeah. Give him a round of applause. He is actually with Equity Trust. That is where people who move a certain amount of money, you know, kind of have to put their stuff at – for thinking of things. But I wanted to introduce him to you, and he's going to be here with us tonight and tomorrow so if you have any questions specifically about what I do, I figured, why not just bring the expert with me? So you know it's something when the bank flies out your banker to hang out with you. So I thank him for that, he's been a joy with our firm and really helped us out to do a tremendous amount of community redevelopment that we've done in the community. ... (RX-66, pp. 218-19, transcription pp. 217-18)
>
> ... I need you, before you go out and jump out the window, to consult with a qualified, educated and informed financial professional. ... Now if you don't have one or if you don't like the one you have because they've been losing all your money, I brought mine with me. He's right there. Robert, you might get bombarded, they might have the security escort you right now. (RX-66, pp. 244-45, transcription pp. 243-44)

Not only are Taylor's comments describing Equity Trust incoherent, but his description of Batt's role was utterly inaccurate and contrary to Taylor's knowledge regarding the role played by SDIRA custodians. (Batt Tr. 462-63) While Batt stood briefly as directed and waved, he did not have a microphone to correct or otherwise respond to Taylor's description in the huge church sanctuary. Indeed, Batt did not utter a single word during the entire two-and-a-half hours and simply sat silently in the audience. (Wells Tr. 64-66; Turner Tr. 1351-52; Batt Tr. 461-63) In light of Taylor's national exposure – appearing on popular television shows, at political events, and in business magazines – plus the solid endorsement by New Birth Church and its Bishop – this stone silent appearance by Batt as a figure out in the audience counted for nothing. This was plainly not an "endorsement of" or "vouching for" Taylor or City Capital. Nor did Taylor's unilaterally calling Batt his "banker" – with Batt lacking a microphone to reply – convert Taylor's unilateral and incoherent comments into an endorsement by ETC.

After Taylor's presentation, Batt spoke to a small number of persons in the church's lobby about the process for opening a self-directed IRA. Batt only provided general information on SDIRAs and gave what he called his "stock presentation" on SDIRAs where he would describe "buying a property, flipping a property, putting a cell phone tower inside an IRA." (Wells Tr. 68-69; Batt Tr. 455-57, 465) Batt returned to his hotel after the event. He then flew back to Ohio early the next morning and did not participate in the one-on-one meetings City Capital had with New Birth Church members in the church's conference rooms over the days that followed, at which Taylor's staff made their sales pitches for specific investments in City Capital and its affiliates. (Batt Tr. 463)

On returning to his office, Batt told his supervisor Keith Marsh about Taylor's reference to Batt as a "banker" at the Atlanta church event. Batt did not feel that he had endorsed City Capital, and he was fully aware that if an ETC representative endorsed an investment sponsor "you'd get fired." (Marsh Tr. 244; Batt Tr. 411-12, 463-65) ETC took no further action to correct Taylor's reference to Batt, but just two months later as discussed below, following a review required by volume and concentration levels, ETC put Taylor on "hold" status and ceased taking new business from him. (DX-534, p. 2; Batt Tr. 465-66)

(7) New Birth Members' Investments (November and December 2009). The Division presented testimony from three New Birth members who invested with Taylor following the October events hosted by the church. Each described his or her own reasons for investing with Taylor, but in each case Batt's presence at New Birth was at most a background point:

(a) [redacted] Wells had been a New Birth member for over 20 years, attended church multiple times each week, and was active in church ministry work. (Wells Tr. 40-42) Bishop Long had "a high influence over what [she] did ... because [she] looked at him as a father figure." (Wells Tr. 45) Wells studied applied behavioral sciences in college and subsequently attended real estate school. She enjoyed a [redacted]-year career at AT&T and was working as a licensed real estate broker at the time of her investment. (Wells Tr. 81-82) As a realtor, she dealt with contracts and other documentation. (Wells Tr. 82)

Wells attended several of the New Birth events at which Taylor spoke. After the Bishop's introduction of Taylor at the Sunday morning program, Wells heard Taylor tell the congregation that he could lead them to "Godly investments," unlike what mutual funds did. It was important to Wells to avoid "ungodly things." After hearing Taylor on Sunday, Wells was "kind of excited" about Taylor and accepted him as a "man of God." (Wells Tr. 52-56) After hearing Taylor speak on Tuesday evening, Wells viewed Taylor as a smart person who "had information on how it would help us to get money back, get our money back to grow again instead of continuing to lose." (Wells Tr. 63-64) Wells returned to New Birth later that week for a one-on-one meeting with Taylor's associate Ferguson, who was the one who actually pitched her on making a particular investment and told her that Bishop Long was also investing with them and that "I know that we wouldn't mess up with his money, so we're not going to let that happen to you guys." ETC did not participate in that meeting. (Wells Tr. 72-77) Prior to attending the New Birth events, Wells had never before heard of ETC or the other SDIRA custodians used by Taylor. (Wells Tr. 94-95)

Wells approached Batt in the church lobby after the Tuesday evening event. Batt told her that she could "do a self-directing IRA" and referred questions about City Capital to Taylor and his staff. (Wells Tr. 70-72) She did not speak further with Batt, and an ETC operations person helped her complete her funds transfer into an SDIRA. (Wells Tr. 79-80) Her DOI form directed ETC to deliver funds to City Capital for an unsecured loan. Her DOI acknowledged that ETC did not recommend her investment, that she was responsible for the "selection, due diligence, management, review and retention" of her investment, and that ETC was not acting as a fiduciary. (RX-183; Wells Tr. 84-94)

(b) [redacted] Jones, similar to Wells, also was a member of New Birth for over 20 years attending most Sundays and occasionally during the week. He considered Bishop Long an "upstanding pastor, man of God, community leader, a heart for the people," as someone that "hears directly from God and he shares what he hears with the flock in terms of your question about influence," and who over the years "earned that trust of his parishioners." (Jones Tr. 127-29) Jones' educational background included a college biology degree and an MBA with "at least three or four" finance courses, and work as a science teacher and small business owner. (Jones Tr. 122-27)

After hearing Bishop Long introduce Taylor as a "man of God" and hearing Taylor speak at the Sunday service, Jones spoke personally with Taylor himself in the church lobby, where he bought an autographed copy of Taylor's book. Jones then met with Taylor's assistant Stacey Harvin, who escorted Jones into a private meeting with others from Taylor's staff in a church conference room. (Jones Tr. 136-39) At this Sunday meeting with Jones, another one of Taylor's associates, Wendy Connor, discussed investing. Batt was not present at this meeting. (Jones Tr. 150-51) Jones decided to make his investment with Taylor "based on the recommendation coming from – actually, it was Ms. Connor [Taylor's associate] who came to us and told us that our interest rate – what that would be and the company we were being matched with." (Jones Tr. 112-13)

On Tuesday evening, Jones returned to the church as people were leaving after Taylor's presentation, and spoke with Batt. Aside from describing "the details of how the self-directed IRA actually worked" and examining the application, all that Jones recalls is Batt generally making "glowing" remarks about Taylor's "reputation, the type of work he was doing in the community being good work." (Jones Tr. 111-12, 145-47) Prior to Taylor's appearance at New Birth, Jones had never heard of ETC. (Jones Tr. 100) He "understood that Equity Trust would act as the custodian to handle the financial transfers." (Jones Tr. 149) Other than the Tuesday evening conversation, Jones had no other conversations with Batt. (Jones Tr. 157) Jones' DOI form directed ETC to deliver funds for an unsecured loan to Resilient Innovations, a Taylor-affiliated entity. As with all other DOIs submitted by Taylor's investors, Jones' DOI acknowledged that ETC did not recommend the investment, that he (Jones) was responsible for "selection, due diligence, management, review and retention" of the investment, and that ETC was not a fiduciary. (RX-142; Jones Tr. 151-59)

(c) [redacted] Turner had attended New Birth for approximately 18 years. (Turner Tr. 1374-75) Her spouse, as an elder at New Birth, sat on stage behind Bishop Long at services. The Turners tithed to the church each year, and over time had donated over $40,000. (Turner Tr. 1375-77) Turner held a bachelor of science degree in health administration and had owned a temporary employment service for radiology technologists for seven years, after which she worked at DeKalb Medical Center performing CAT scans. (Turner Tr. 1346-47)

Based on Bishop Long's introduction of Taylor at the Sunday service, Turner thought Taylor was coming in the name of the Lord and was completely trustworthy. (Turner Tr. 1379-81) Turner returned for Taylor's Tuesday evening presentation, and afterwards she talked to Batt for "two or three minutes" in the front of the audience section of the church. Turner did not consider this a "formal" conversation, however, and this brief exchange was the only time Turner spoke with Batt or anyone from ETC until learning of her loss much later. (Turner Tr. 1371-72) Prior to the New Birth event, she had never heard of ETC although she had previously seen Taylor on the Montel Williams television show. (Turner Tr. 1351, 1378-79) After Tuesday evening's program, Turner and her spouse had a meeting with two of Taylor's associates in the church's upstairs conference rooms, and they instructed the Turners to return the next day with account statements showing their current investments. The next day, the Turners returned to the church to meet with Ebony Rowland, who looked at their investments and helped them fill out an ETC account application. (Turner Tr. 1356-58, 1382-84) Rowland explained that while she worked for City Capital, she had been trained on how to fill out the ETC account application. (Turner Tr. 1360) A few weeks later, Turner and her spouse had a personal meeting with Taylor, Rowland and another member of Taylor's organization at a downtown Atlanta hotel. (Turner Tr. 1383-84, 1392-93)

During her meeting at the church with City Capital's representatives, Turner began reading the particular provisions set forth on the fourth page of ETC's DOI form, and Rowland proceeded "to paraphrase everything for me." (Turner Tr. 1363) Turner's DOI, like all others in the case, disclosed that ETC did not recommend the investment, that she alone was responsible for "selection, due diligence, management, review and retention" of the investment, and that ETC was not a fiduciary. (DX-696, p. 160; RX-178, 179) While the Turners funded their ETC accounts with over $173,000, only approximately $11,500 was invested with Taylor. Shortly after opening their ETC account, they directed ETC to transfer the $162,000 remaining in their ETC accounts to a different SDIRA custodian, Sunwest Trust. This was done based on instructions the Turners got from City Capital. In addition to transferring these funds at the direction of City Capital, the Turners also invested an additional $27,000 in non-IRA money directly with City Capital by simply handing a check to Rowland. (Turner Tr. 1365-67, 1385-90)

D. "Hold" on Taylor-Related Investments

(1) ETC's Review and "Hold" Determination (December 2009). Beginning in late 2009 – years before any hint of SEC or Justice Department concern about Taylor – ETC conducted what it referred to as a "secondary review" of its customers' investments in City Capital. This was one of the first secondary reviews conducted as part of ETC's new investment review process, and ETC's President and Chief Financial Officer Michael Dea was personally involved in the review. (Dea Tr. 1579-82) Secondary reviews were not triggered by any suspicion of fraud or other wrongdoing, but rather were "[p]urely based upon the concentration risk to Equity Trust," *i.e.,* the number of ETC customers invested and total amount invested. "The intent of the ... review process is not about the detection of fraud. It's all about the management of risk to Equity Trust." (Dea Tr. 1580-81)

ETC carried out the City Capital secondary review in the September-December 2009 time period. Accordingly, the review was in its early stages at the time of Taylor's New Birth event. At the time, there had been no customer complaints about Taylor or City Capital. ETC's review of customer files showed, however, that ETC had complete documentation for approximately 50% of the 47 City Capital investments held by their customers. During the course of the review, ETC "requested missing documents" from City Capital, which City Capital personnel promised to supply. ETC's in-house counsel also interviewed Taylor personally. ETC's review revealed "no relevant securities violations," and "no negative news articles" concerning either City Capital or Taylor. (RX-50; Dea Tr. 1583-84) Based on its Lexis-Nexis search, ETC confirmed that Taylor continued to have a "very positive" reputation in the marketplace. Nevertheless, after reviewing City Capital's SEC filings on EDGAR, including its financial statements, Dea noticed that City Capital had a negative net worth, was losing money very rapidly, had many maturing loans, and that its auditors found deficiencies in its internal controls. (Dea Tr. 1585-86)

The last Taylor-related investment accepted by ETC was on December 21, 2009. (DX-40, p. 14) Two days later, ETC determined to put City Capital on "hold" status and not accept new business. Approximately three weeks later, on January 13, 2010, ETC completed its secondary review and determined to put City Capital on "DNP" (do not process) status, noting that "[d]ue to poor financial information and high concentration of unsecured notes decision was made that any further investments are not administratively feasible." (RX-50; Dea Tr. 1583-85) Although ETC had no suspicion that City Capital was running a Ponzi scheme or otherwise violating federal or state law, we "believed at that time that we had enough exposure to City Capital." (Dea Tr. 1586, 1589)

The phrase "not administratively feasible," as used by ETC and other SDIRA custodians, meant simply that "[c]ontractually the firm has decided that they don't want to process the investment." This "could be for a number of different reasons," which "could be fraud-based, it could be we just choose not to hold it," or "any number of things," and it would "[n]ot necessarily ... stand for fraud." (Marsh Tr. 262-63; Dea Tr. 1589-90; Desich Tr. 984-87). While no disclosure of the DNP status or lack of administrative feasibility was required by the account agreements, ETC's quarterly account statements continued to advise its existing custodial customers already invested in City Capital of any missing documentation and maturity dates, and customers with matured notes were aware that their notes had not yet been paid.

ETC's Governance, Risk and Compliance Committee, composed of members of ETC's senior management team, was responsible for placing City Capital on the DNP. (Dea Tr. 1586-87) While Batt was not aware of any wrongdoing by Taylor or City Capital and had no suspicion that their investments were fraudulent, nor even aware that the secondary review was taking place while he was at the New Birth event in October 2009, he did not in any way attempt to push back or otherwise object to ETC's determination as to City Capital. At the point Batt learned of the determination to put City Capital on the DNP, he stopped all interaction with City Capital and simply forwarded any voicemails and emails he received from or about City Capital to his supervisor, Keith Marsh. (Batt Tr. 466-67, 468-71)

(2) ETC's Reclassification of Certain Notes (January 2010). During ETC's secondary review of the City Capital investments held by its customers, an ETC internal audit employee questioned whether some of the City Capital notes classified on ETC's records as secured should instead be classified as unsecured. (DX-374) Ultimately, in January 2010, ETC's internal audit personnel concluded that "[b]ased on the audit / compliance review of the investments – the notes that are classified as 'Secured by Other' will need to be revised to the Unsecured Note class." (DX-434)

Notwithstanding this change in the reporting status of those notes, all of the files for customers with notes marked "secured" contained both (i) the customer's signed DOI form in which the customer described the note as being "secured" by the "company," and identified City Capital as the "company" ; and (ii) a copy of the note itself, signed by both the customer (as lender) and City Capital (as borrower), containing City Capital's promise to pay without reference to specific collateral. In virtually every case, the customer signed both the DOI form and the note on or about the same day, as shown in the date columns on the Division's tabulation exhibit. (DX-40, pp. 10-14) By simultaneously signing the DOI form and the note, the customer saw that the DOI form's description of the note as "secured" by "the company" referred simply to the company's promise to pay as reflected in the promissory note. No other form of security or collateral was stated in either document.

The only two ETC customers called by the Division as witnesses on this point, [redacted] Sims and [redacted] Dorio, testified that having a note "secured" by City Capital itself was an expression of City Capital's promise to pay the note, and not a pledge of some unidentified collateral as additional security. [redacted] Sims' DOI form directed ETC to send $50,000 to City Capital for a secured loan with "the company" itself as collateral for the loan. While she said a secured note was important, she understood this to mean simply that the company itself, City Capital, "would be responsible for, you know, paying the money back." (Sims Tr. 1445) In this respect, the DOI form she signed was the same as the undertaking in the promissory note, which she also signed. (Sims Tr. 1407-08, 1446-47) The other witness, [redacted] Dorio, similarly stated her understanding that "secured" by the "company" meant that, "if someone didn't pay the note, then that would mean that the company is the collateral," and that the company would have to stand by the promise to pay. (Dorio Tr. 880-81)

Questions relating to collateral and documentation were squarely the responsibility of the customer, not ETC. In confirming each customer's investment, ETC's "onboarding" letter to the customer emphasized (i) that the customer was responsible to "verify with your investment company or the person responsible for securing your collateral that they have performed accordingly to protect your interest"; and (ii) that the customer, not ETC, had the "responsibility to guarantee delivery of all documents pertaining to your investment(s) to Equity Trust Company." (RX-142, p. 10)

(3) Charges Against Taylor (2012 and 2014). On April 12, 2012, more than two years following ETC's decision to stop accepting new investments with City Capital, the SEC charged Taylor and City Capital with scienter-based (*i.e.* reckless or intentional) violations of Sections 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder in connection with the promissory notes he and City Capital had offered. On August 8, 2012, the court entered a partial judgment as to Taylor, which enjoined Taylor from future violations of these provisions, and also barred Taylor from acting as an officer or director of a public company. On March 7, 2013, the court entered a default judgment against City Capital. (OIP ¶26)

On June 10, 2014, more than four years after ETC's decision to stop accepting new investments with City Capital, Taylor was indicted by a federal grand jury on charges of conspiracy, mail fraud, and wire fraud in connection with his sale of promissory notes and sweepstakes machines. The U.S. Attorney's Office stated in its Sentencing Memorandum that Taylor (along with his co-defendant, Wendy Connor), had defrauded over 400 victims of approximately $16 million, and that his scheme "targeted African-American Christians from around the country, including churches in Atlanta, Houston, Raleigh and Decatur, Alabama." Taylor pled guilty to one count of conspiracy on October 8, 2014. On March 17, 2015, Taylor was sentenced to 235 months in prison. On October 29, 2014, the Commission, pursuant to Section 15(b)(6) of the Securities Exchange Act, barred Taylor from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and from participating in any offering of a penny stock. (OIP ¶27)

III. FACTS PERTAINING TO RANDY POULSON

At all relevant times, Randy Poulson ("Poulson") was the co-owner of Poulson-Russo LLC ("Poulson Russo"), a for-profit educational firm providing educational programs and materials to people interested in investing in real estate in southern New Jersey. Poulson Russo ran educational seminars and monthly dinners featuring speakers on a variety of topics related to real estate investing, including buying and selling real estate, short sales and foreclosures. It presented itself as "the premier real estate investment education and training company in New Jersey." (Poulson Tr. 571-74; Gatto Tr. 1328-29) Its seminars were purely educational as were its dinner events marketed under the name "Poulson Russo Real Estate Wealth Alliance." (Poulson Tr. 580, 593-94) In addition to these seminars and dinner events, Poulson Russo sold access to private consultations and online materials for $295 and more per month. (Poulson Tr. 585-87)

Apart from operating Poulson Russo's educational business, Poulson engaged in his own real estate investment business by borrowing funds both personally and through his entity Equity Capital Investments, LLC. (Poulson Tr. 561-62) The majority of Poulson's lenders did not use an SDIRA to make their loans. For those that did use an SDIRA, some used an ETC self-directed IRA to fund their loans, while others used different SDIRA custodians such as Entrust and Provident. (Poulson Tr. 555-56) Poulson said he recommended ETC as custodian simply because he had seen ETC appear at real estate investment education events hosted by others, and thought ETC was "a good enough company" for him to recommend. (Poulson Tr. 505-06)

A. ETC's Contact With Poulson

Over the four-year period between 2007 and 2011, a number of individuals opened ETC self-directed IRA accounts to lend money to Poulson. OIP ¶52 alleges that there were 26 ETC customers who invested an aggregate of $800,000, but DX-41 alleges that there were 34 ETC customers who invested an aggregate of $984,998. Regardless of the exact number of ETC accounts involved or exact dollar amount of funds loaned, these totals represented only a very small portion of ETC's overall custodial business, which included approximately 130,000 self-directed IRA accounts. ETC received only its standard custodial fees in connection with each of these custodial accounts.

ETC assigned one of its employees, Irene Berlovan, to work with Poulson. (Poulson Tr. 505) For Poulson, this meant that "[s]he was essentially the point person that if anybody had any questions or wanted any information regarding setting up an IRA or any questions pertaining to that, I would refer them to her." (Poulson Tr. 505) Prior to joining ETC, Berlovan had spent 11 years working at Key Bank, beginning in customer service and advancing to relationship manager, as well as one year as a mortgage specialist at Quicken Loans. (Berlovan Tr. 1202-03, 1233) Upon joining ETC, Berlovan got four or five weeks of "intense training" in a classroom setting on the "concept of self-directed IRAs, how they could be used [and] the passive custodian role that Equity Trust played...." During this training "it was emphasized that we should be not soliciting any investments or leading people to investments." Berlovan understood "that we were not to vouch for the legitimacy of the investment," which made sense in view of ETC's limited knowledge concerning any investment. (Berlovan Tr. 1205-06) Berlovan's supervisor, Keith Marsh, testified that he was not aware of Berlovan ever endorsing an investment sponsor, which could be grounds for termination at ETC. (Marsh Tr. 257-59; Desich Tr. 983, 1022)

As described below, Berlovan appeared at only one Poulson Russo educational seminar, held in April 2009. Before her attendance at this seminar, Berlovan emailed Poulson to advise him that Jeanette Arnholt, an ETC Channel Marketing Manager, would "work to identify ways Equity Trust can support you from a marketing perspective." (RX-74) Poulson testified that "at the time, my partner, Anthony Russo, and I were in the process of creating our own real estate investing education curriculum and we were looking to work with various experts in a variety of industries relating within the real estate community." (Poulson Tr. 507) Arnholt sent an internal email noting that Poulson "was working on his Education Mentoring Program," and that she had "sent him the list of items I will need to submit to the committee to review if we can 'partner' with him or not." (RX-75) Approximately one month before the Poulson Russo April 2009 event, Arnholt sent an internal ETC review committee Poulson Russo "files to review," including marketing materials and its "operating agreement, certificate of formation and a presentation." She noted that Poulson was "a client and had consistently been referring people"; that he had formed "an Education Mentoring Company called Poulson Rosso LLC ... to bridge the gap between investor and seller"; and that he was "looking for an exclusive arrangement with

Equity Trust" in his region. (RX-76) Despite the referrals and Poulson's reputation as real estate education investment expert, ETC appeared at just the one April 2009 Poulson Russo seminar.

Several months after the April 2009 seminar, Poulson sent an email to various entities engaged in the Southern New Jersey real estate investment industry, including title companies, appraisal firms, lawyers, accountants, real estate management companies, insurance brokers, as well as ETC, asking them whether they would agree to serve as a year-long sponsor of the Poulson Russo monthly dinner events in exchange for $600/year. This email described the events to be focused on "'National-Caliber' education with absolutely NO sales agenda from the stage ... and a 'comprehensive two-hour educational module straight from the Poulson Russo curriculum'...." (DX-160) ETC initially indicated that it would be a sponsor. Around the same time, Poulson initially indicated that he would pay $750 to sponsor a session at an ETC conference he was personally unable to attend. In fact, ETC never actually did pay to sponsor the Poulson Russo education dinners, and Poulson never actually did pay to sponsor an ETC event.

When Berlovan left ETC to join Dollar Bank in May 2010, ETC assigned Robert Yurgalewicz as Poulson's contact. (Poulson Tr. 536-37) Berlovan did not groom or otherwise assist Yurgalewicz in assuming the role as Poulson's contact. (Berlovan Tr. 1239-40) The reality was that Poulson was an insignificant referral source of custodial accounts to ETC over the course of the four years during which he referred customers. (Berlovan Tr. 1236-37)

B. Poulson's Public Profile and Business

(1) Poulson's Regional Prominence. People loaned money to Poulson based on his status as, in his words, "New Jersey's real estate investment expert." (Poulson Tr. 574) During much of the relevant time here, Poulson served as President of the South Jersey Real Estate Investors Association ("SJREIA," f/k/a South Jersey Investors), the leading non-profit real estate investment group in southern New Jersey. During this time, SJREIA had approximately 800 regular members, and some of its events featuring national speakers drew up to 300 attendees. (Poulson Tr. 576-78; Jablonski Tr. 1754-56, 1758) Poulson also led the New Jersey Association of Real Estate Professionals – a lobbying group formed by SJREIA and two other real estate investor groups to oppose certain legislation impacting the real estate industry. (Poulson Tr. 579-80)

Ron Jablonski, who succeeded Poulson as SJREIA president and knew Poulson while he was president, described Poulson as "a very educated person" who "knew everything there was to know about how to transact real estate," and who "had credibility" with the investor group. (Jablonski Tr. 1758-59) [redacted] Gatto, who later served as SJREIA's treasurer and its executive director, confirmed that Poulson "ran the organization," "would pick national speakers" for its events, "ran the main meeting" each month, and spoke knowledgably about real estate investment topics. (Gatto Tr. 1282-84) In fact, Gatto and several other SJREIA officers and directors, who dealt directly with Poulson on SJREIA activities, personally invested with Poulson. (Jablonski Tr. 1762; Gatto Tr. 1285-86)

People also loaned money to Poulson as a result of attending his numerous real estate seminars and other events across New Jersey and surrounding areas, including seminars offered by his Poulson Russo educational business as described above. Poulson was highly self-promotional. The signature block in his emails touted Poulson as the "President, New Jersey Association of Real Estate Professionals"; "President, South Jersey Investors, Inc."; "Lead Instructor, American Real Estate Investors Institute"; "Author and Creator of The Market Dominator Course Instruction Series" on real estate investing; and "Founder/Partner" of Poulson Russo, LLC, "The Premier Real Estate Investment Education and Training Company in New Jersey." (RX-59, 74; Poulson Tr. 575-576) His online profile on Linked-In contained additional credentials. (RX-34)

(2) Poulson's Business Model. After several years of buying and selling multi-family properties on his own, Poulson, in 2006, developed a new plan to make money on real estate. He would borrow money from individuals in return for a promissory note, and use the borrowed funds to buy at a discount single-family houses facing foreclosure. Poulson would then take title to the property, assume the existing mortgage, and after making any necessary repairs, lease the property to a tenant with an option to buy, generally at a predetermined price higher than what he had paid. His plan was to thus resell the property within 1-3 years. After satisfying the remaining mortgage balance and paying off his promissory note lenders with a balloon interest payment, he hoped to clear a profit of between five and ten percent for himself. (Poulson Tr. 546-50, 562-64)

Poulson was confident this plan would work. He saw "a multitude of people out there that were doing it," and thought that the plan did go "fairly well" at the outset. (Poulson Tr. 550-51) However, after the real estate and financial market collapse began in 2008, his tenants "were not paying their rent," and with credit tightening, "it was becoming that much more difficult for them ... to be able at some point in the future to exercise their option" to buy their residence from Poulson. (Poulson Tr. 551-53) Eventually, by "probably sometime in ... 2010 or 2011," it became apparent to Poulson that his plan was not going to work. With tenants not able to pay their rent and not able to exercise their option to buy, Poulson was unable to pay off his promissory notes that were becoming due, and facing their own difficulties in the financial crisis, his promissory note lenders were demanding their money. (Poulson Tr. 553-54)

C. No Endorsement of Poulson

(1) Gatto's Loans (March 2008 and March 2009). The Division called [redacted] Gatto, an engineer with a bachelor's degree in aerospace engineering and a master's degree in physics. Gatto had made multiple real estate investments and held a New Jersey real estate license. (Gatto Tr. 1255-56) Poulson and Gatto first met in 2005 or 2006 through the SJREIA. (Poulson Tr. 564-65, 577) Gatto began attending SJREIA meetings as a visitor, and then became a member in or around 2008 when Poulson was serving as SJREIA's president. (Gatto Tr. 1278-82)

At some point during 2008, probably around March 2008, Gatto decided to loan money to Poulson to partially fund one of Poulson's real estate investments. Gatto used funds from his regular savings account – and not an SDIRA – to make this loan to Poulson. Gatto understood that Poulson would use his funds to buy the property at a price below or close to the outstanding principal balance of the mortgage, make any needed repairs, and then lease it to a tenant with an option to buy, all with the hope of selling the property at a profit in just a couple of years. This transaction, his first with Poulson, did not involve ETC in any way. (Gatto Tr. 1321-23)

The following year, Gatto entered into more real estate deals with Poulson. In or around January 2009, the parties discussed additional loans to Poulson that would follow the same model as Gatto's previous loan to Poulson, *i.e.*, loans used to finance Poulson's purchases of properties that Poulson would lease to tenants with options to buy. Poulson and Gatto discussed this proposal in several meetings, once at a local diner and the other times during networking periods at regular SJREIA meetings. During these meetings Gatto felt "comfortable" loaning money to Poulson so that he could purchase additional properties. (Gatto Tr. 1295-96, 1298-99)

"When [Gatto] had decided that, yes, [he] want[ed] to make an investment" in these additional properties with Poulson, but this time using an SDIRA, Gatto then "had to decide where I was going to put my money to make that investment." (Gatto Tr. 1299) That is, he needed to find an SDIRA custodian, as he could not make the loans using his existing Fidelity IRA. Gatto considered three possible SDIRA custodians - Checkbook IRA, Entrust, and ETC. While Checkbook IRA "didn't pass the smell test," Gatto considered Entrust and ETC acceptable. He initially preferred Entrust because it had a local office. Entrust also was a "business affiliate" of SJREIA and made brief presentations at its meetings. Ultimately, after a phone conversation with Berlovan, Gatto decided to use ETC as his SDIRA custodian, and started the account opening process during his phone call with Berlovan. (Gatto Tr. 1286-90, 1296-1300, 1336-37)

While Gatto claimed Berlovan made unspecified "glowing" remarks about Poulson during this phone call, Gatto testified three times that Berlovan's remarks simply made Gatto want to use Equity Trust as custodian instead of its competitor Entrust. Berlovan's comments "made me go with Equity Trust"; "sort of sent me over to Equity Trust"; and "took me over from ... Entrust." (Gatto Tr. 1261, 1262, 1288-89) Gatto did not say influenced him to invest with Poulson. Gatto had already invested with Poulson almost a year earlier and had already decided to make these new loans to Poulson. All Gatto was doing in his phone call with Berlovan was setting up an SDIRA as he was planning on using retirement funds for these new loans.

After funding his SDIRA, Gatto made three loans to Poulson in March 2009 – with Poulson borrowing individually and not through any company – in the amounts of $30,000, $60,000 and $25,000, respectively – for Poulson to use in connection with the purchase and lease of three residential properties in southern New Jersey. (RX-200) For each loan, Gatto sent ETC a DOI investment direction form, an unsigned copy of the promissory note, and an unsigned mortgage. For each, ETC sent Gatto the usual confirmation letter advising Gatto that the funds had been sent to Poulson, and reminding Gatto that it was his responsibility to send ETC all signed documentation for the transactions and to assure that appropriate arrangements were in place to provide any security agreed upon for the transaction. Gatto admits that he never verified "anything about the collateral or whether it was a recorded mortgage or anything of that sort." And by signing the DOI form, Gatto agreed and acknowledged that he alone was personally responsible for all aspects of the investment and that ETC was not a fiduciary for his account. (RX-200; Gatto Tr. 1300-03, 1305-14)

Gatto realized that Poulson would use the funds from his March 2009 loans to purchase each of the properties at a purchase price close to the amount of the outstanding principal balance of the existing mortgage on each residence. Gatto understood that this meant that there would be virtually no equity in the property to secure repayment of his loan. As an experienced real estate investor, Gatto also understood that there could exist a variety of additional and earlier recorded liens on each property, including second and third mortgages, municipal tax liens and other creditors' liens. Gatto understood that the only way to determine this would be for him to do a title search on the property, but he chose not to have a title search performed for any of these three properties. He also chose not to have an appraisal of any of the three properties to determine their respective fair market values. Gatto did not even drive past any of the properties, even though all three were in the local area, to confirm the existence or condition of any residence on the properties. (Gatto Tr. 1303-05, 1309)

At or around the same time as his March 2009 loans to Poulson, Gatto also directed ETC (through a separate DOI) to send $115,000 to Walter Wall, who also was active in SJREIA, as a secured loan. Gatto testified that his loan was supposed to be secured by Wall's half interest in Wall's brother's company, called Modular Concepts, but Gatto was unclear as to how this arrangement would work. Modular had built a spec house that it was leasing to a tenant with an option to buy. (RX-200; Gatto Tr. 1316-20)

Throughout 2009, 2010 and 2011, ETC sent Gatto quarterly statements that listed the principal amount, interest rate and maturity date for each of the three loans to Poulson and his loan to Wall. (RX-200; Gatto Tr. 1326) During this time, Gatto rose up in SJREIA to become first a board member and then its treasurer. (Gatto Tr. 1279) Each of the quarterly statements advised Gatto that, as to each of the four loans (the three to Poulson and one to Wall), ETC still had not received from Gatto a signed copy of the promissory notes. (RX-200; Gatto Tr. 1314-18, 1330-33) As the maturity dates approached and passed with each of the four loans remaining unpaid, ETC's quarterly statements continued to advise that ETC still had not received signed promissory notes from Gatto on all four post-maturity unpaid loans.

Later in 2009 and again in 2010, Gatto made two more loans to Poulson outside of Gatto's SDIRA, again for Poulson to buy properties following his usual business model described above. So in all Gatto made a total of six loans to Poulson – one in March 2008 not using an SDIRA, three a year later in March 2009 using his SDIRA, and two more in later 2009 and 2010 not using his SDIRA. (Gatto Tr. 1322-25) Gatto himself went on to become SJREIA's executive director, a position he held until 2015 and left shortly before the hearing in this matter. (Gatto Tr. 1279) A month after making the three SDIRA loans to Poulson in March 2009, Gatto attended part of the four-day April 2009 Poulson Russo Runnemede seminar described below, but he attended on the day before ETC was present and did not see anyone from ETC at the seminar. (Gatto Tr. 1333-35)

(2) Poulson Russo's Runnemede Seminar (April 2009). On April 17 and 18, 2009, Berlovan and Edwin Kelly, a speaker with ETC's affiliated Retirement Education Group, attended a Poulson Russo educational seminar at the Holiday Inn in Runnemede, New Jersey. This was the one and only Poulson Russo or other Poulson-related event that anybody from ETC ever attended. Before the seminar, Poulson emailed marketing materials to ETC referring to Poulson Russo as a "preeminent training, coaching, and mentoring company" offering "national caliber training for real estate entrepreneurs." (RX-77; Berlovan Tr. 1237) The seminar drew an audience of 180-200 and cost $2,000 - $2,500 to attend. (Poulson Tr. 582-83)

Berlovan's supervisor Keith Marsh testified, based on his experience at ETC and elsewhere, that SDIRA custodians routinely attend such events to speak about the benefits of SDIRAs. (Marsh Tr. 260-61) After ETC, Marsh went on to work at SDIRA custodian Horizon Trust Company and at SDIRA administrator Specialized IRA Services. He testified that at Horizon Trust its representatives attended such events and also had books to educate investors about SDIRAs, and that at Specialized IRA Services, "[w]e attend events, ... try to educate ... and we focus a lot on real estate and maybe precious metals ... and we'll attend events. It could be REIA [Real Estate Investor Associations]. It could be any kind of thing where we can educate someone on a self-directed IRA." Specialized also uses an e-book and webinars for this purpose. (Marsh Tr. 274-75) Kelly, who went on to work with Marsh at Horizon and Specialized, testified how there can be five or six competing SDIRA custodians appearing at a single educational event in the hope of opening new SDIRA accounts. (E. Kelly Tr. 625-27)

At the April 2009 Poulson Russo seminar, Berlovan and Kelly each gave a presentation that the event transcript shows was focused solely on the benefits of self-directed IRAs, and not about Poulson or any entity connected with him. Berlovan's presentation was simply an introduction that lasted literally only a couple of minutes, and she then sat out in the hallway with other vendors to hand out SDIRA information. (DX-824, pp. 269-71; Berlovan Tr. 1221-22, 1234-35; E. Kelly Tr. 635) Kelly gave an educational presentation on SDIRAs. (Poulson Tr. 587; E. Kelly Tr. 631-32) Indeed, by making a presentation regarding the myriad uses of an SDIRA, the ETC representatives were suggesting alternative investments that effectively stood in competition with the promissory notes that Poulson was offering. (E. Kelly Tr. 632-33; Desich Tr. 982-83) And Kelly's presentations and materials warned against investment fraud and made clear in multiple places that ETC did not endorse any particular investment or investment strategy. (E. Kelly Tr. 629-31)

While at the April 2009 event, Kelly also sold ETC's educational CD sets that promoted the general benefits of using self-directed IRAs to invest in a wide variety of investment categories, such as cell towers and real estate. ETC split proceeds from its own CD sales with Poulson Russo as the event host – here paying the host $4,819 – which was consistent with both ETC and industry practice. (RX-20) Based on their experience at ETC and later at two other SDIRA custodians, Marsh and Kelly both testified that splitting such educational CD or book sale proceeds with the event host "was common" practice in the industry. (Marsh Tr. 261; E. Kelly Tr. 627-29) Poulson and another SJREIA president both further confirmed that splitting proceeds from the sale of educational materials with the event's host was, in Poulson's words, "very typical within the industry." (Poulson Tr. 588; Jablonski Tr. 1763)

(3) [redacted] Savary's Investments (November 2009 and May 2010). The Division called [redacted] Savary, an environmental engineer with a bachelors degree in chemistry. Savary initially became a real estate investor by purchasing, for $250,000, a multi-family apartment building. After some time trying to operate this apartment building, and to develop his real estate knowledge and skills, Savary joined SJREIA in 2008 and there met Poulson. Savary attended SJREIA "fairly frequently," including its monthly meetings and weekend seminars. At the time, Poulson was SJREIA's president, and Poulson was a good speaker and "appeared to be knowledgeable" and "successful" in real estate matters. Savary's spouse had a bachelors degree in marketing, worked in the logistics supply chain end of the apparel business, and participated in his real estate investment activities. (Savary Tr. 1099-1102, 1105)

Savary attended the four-day April 2009 Poulson Russo Runnemede seminar described above. Along with introductions of accountants, lawyers, a title abstract company, a financial strategist, an insurance agent and others, Savary testified that there was a "mini-presentation" by ETC. Savary "may have been there but I wasn't paying attention because at that time, didn't really have an immediate need" for an SDIRA. He had a conversation with Berlovan at the event that "was just, you know, formalities, just, you know, hello, how are you, what do you do, that's it and here's some information." (Savary Tr. 1107-12)

In November 2009, more than a year after joining SJREIA and seven months after Poulson Russo's Runnemede seminar, Savary approached Poulson in order to loan "private money" to Poulson, which Poulson was soliciting, to partially fund one of Poulson's real estate investments. Savary used his regular savings – not an SDIRA – to make his November 2009 loan to Poulson. This transaction between Savary and Poulson in November 2009 "definitely" did not involve ETC in any way. The transaction involved the usual Poulson business model described above. Poulson would try to buy the property at a price close to the outstanding mortgage, make any needed repairs, and then lease it to a tenant with an option to buy, all with the hope of selling the property at a profit in just a couple of years. (Savary Tr. 1112-15) In making this November 2009 loan to Poulson, Savary understood that the property in question was "distressed" or "under water." Poulson would be taking over payments on a first mortgage that could be greater than the price of the house, and Savary would only have a "second position" interest that would be junior to the first mortgage. (Savary Tr. 1114-18) Savary did not get a title search that would have listed all prior liens on the property before making this November 2009 loan. (Savary Tr. 1120-21)

Savary's November 2009 loan to Poulson came due six months later in May 2010. Poulson "attempted to pay off ... the principal and interest – he gave me a check. ... But that check bounced." Savary verbally agreed to extend the note, but he did not ask Poulson for any written renewal or extension. This "didn't really bother" Savary because he trusted Poulson based on "his interactions" with him. (Savary Tr. 1118-20)

In early 2010, Savary decided to make a second loan to Poulson, using the same business model as for the first loan, and by January or February, Savary knew the particular property Poulson wanted to buy. But this time Savary would arrange to make the loan using his spouse's IRA account, and he had her open an SDIRA account at ETC for this purpose. Once again, Savary did not bother to do a title search on the property that would have revealed the mortgages and liens already on the property, nor did he drive by the property to assess its external appearance. (Savary Tr. 1121-23, 1137) As before, Savary assumed that the house Poulson wanted to buy was "under water," and that Poulson was paying a price for the property that was less than the amount of the existing first mortgage, on which Poulson would continue to make payments. So again, even if Savary had a title search showing that the first mortgage was the only outstanding lien on the property, the property had no equity that could have secured Savary's junior loan to Poulson. (Savary Tr. 1126-27, 1130-32)

This second loan to Poulson was delayed a couple of months for some unexplained reason, and Savary only directed the investment to finally be made from his spouse's SDIRA account in May 2010. However, as noted above, May 2010 was the very same month that Poulson's check bounced when he tried to pay off the principal and interest on Savary's first loan to Poulson. (Savary Tr. 1125-26) Directly above Savary's spouse's signature on the May 2010 DOI investment direction form submitted to ETC directing the investment, she acknowledged that she alone would be "responsible for the selection, due diligence, management, review and retention of all investments in my account." (RX-214) Savary said he did not view this statement as binding because it was "a form." (Savary Tr. 1133-34)

On May 12, 2010, ETC sent its standard confirmation letter indicating that the funds had been paid from the SDIRA to Poulson, as directed. ETC's letter instructed Savary and his spouse the remit to ETC within 60 days copies of the promissory note and the mortgage. The letter stated that it was the SDIRA owner's responsibility to furnish the documents and to assure that collateral arrangements were in place. (RX-214) Savary never did so. He asked Poulson to send the documents to ETC, but he never confirmed that Poulson did so. (Savary Tr. 1139-44) ETC sent a series of quarterly statements to Savary advising in the "positions held" portion of each statement that ETC was still "awaiting receipt" of documents, but Savary says he did not observe this advice on the quarterly statements. (RX-214; Savary Tr. 1140) Savary continued to be "fairly active" in Poulson Russo networking events and to see Poulson "monthly or every other month." (Savary Tr. 1148-50)

When the second loan came due six months later in November 2010, Poulson still had not paid off the first loan after his payment check bounced. Yet with the first loan still not paid, Savary decided to extend the second loan for another six months, but to increase the interest rate from 15% to 18%. ETC's quarterly statements following the extension of the second loan noted that ETC had received a copy of the promissory note and extension addendum, but that ETC was still "awaiting receipt" of the mortgage. (Savary Tr. 1151-55)

(4) Disclaimer of Appraisal Responsibilities. The Division has offered appraisals of numerous properties Poulson was developing. (DX-38, Carabelli Expert Report) ETC did not independently appraise either Poulson's promissory notes or properties he bought with funds he obtained from the notes. Berlovan's supervisor Marsh testified that it was "pretty typical" in the SDIRA industry – including at the SDIRA custodian he presently runs – to rely on the customer to provide appraisals. (Marsh Tr. 271-73)

In defining the scope of its services as an SDIRA custodian, ETC expressly disclaimed any obligation to provide valuation services, thereby substantially cutting the custodial fees it had to charge. ETC's custodial agreement provided that valuation of assets not listed on "an established exchange or generally recognized market" was necessarily an "estimate" and "should not be relied upon ... for any other purposes." For such assets, ETC would "follow an internal protocol for assigning value based on the cost of the asset," or rely on an appraisal provided by the customer. ETC assumed "no responsibility for the accuracy of the valuations presented with respect to assets whose value is not readily ascertainable on either an established exchange or a generally recognized market." (RX-92, §8.16)

D. "Hold" on Poulson-Related Investments

(1) ETC's Review and "Hold" Determination (2010-11). ETC did a "secondary review" of the Poulson-related custodial accounts at ETC, which involved the same process as the review it had done of Ephren Taylor. (Dea Tr. 1591) This review followed an ETC internal audit that was completed on June 29, 2010. The audit report had noted the following "inadequate documentation": "We have all DOIs[,] 9 mortgages are signed and not recorded, 16 are not signed or recorded[,] 10 Promissory Notes are not signed – titled correctly to IRA." The review showed that four Poulson Notes had matured and were unpaid. (DX-256) When ETC sought documentation from Poulson in November 2010, he promised to provide it, and ETC sent Poulson a list of needed documentation on November 30, 2010. (DX-209)

On January 21, 2011, Poulson sent a portion of the requested documentation to ETC, and offered to send any additional documents still needed, including those "still with either my attorney or my title company." (DX-225) In sending some documentation to ETC, Poulson acknowledges that was stringing along ETC's compliance representative, Mary Juristy. He gave her the documents he had and the extensions he could get signed, all without advising that he did not have any more. (Poulson Tr. 568-70) However he never disputed his obligation to repay the promissory notes, regardless of the completeness of the documentation. (Poulson Tr. 560-61) It was "around this time" that Poulson was first beginning to conclude that his business plan would not work, in view of the ongoing financial crisis. (Poulson Tr. 554)

Four months later, on May 11, 2011 – years before any hint of SEC or Justice Department concern about Poulson – ETC accepted its last investment with Poulson. (DX-41, p. 10) After an internal audit completed on July 11, 2011, ETC further reviewed the Poulson-related custodial accounts. The audit report had identified "inadequate documentation" in 25 out of 33 accounts, and noted that 13 matured notes were unpaid. While it had not accepted a Poulson-related investment since May, ETC determined on November 17, 2011 to formally put Poulson on "hold" status. (DX-256) As with Taylor, the "hold" determination as to Poulson was made by ETC Governance, Risk and Compliance Committee, which included ETC's senior management. ETC did not suspect Poulson of running a Ponzi scheme or in some other way violating federal or state law. (Dea Tr. 1592-94) ETC's account statements continued to advise its existing custodial customers already invested with Poulson of missing documentation and maturity dates, and customers with matured notes were aware that their notes had not yet been paid. No one from ETC knew that Poulson was, at any point, repaying his promissory note investors with newly-raised money. (Poulson Tr. 554-55)

(2) Charges Against Poulson (2014). Three years later, on May 13, 2014, the United States Attorney's Office for the District of New Jersey filed a criminal complaint against Poulson in connection with the notes. On June 5, 2014, a federal grand jury returned an indictment charging Poulson with mail fraud and wire fraud, but not securities fraud. Poulson initially entered a plea of not guilty, but then changed his plea to guilty. (DX-266, 267, 268, 269; Poulson Tr. 490-92) On December 5, 2015, three days after his testimony at the hearing in this proceeding, Poulson emailed the Division that "I sincerely hope that the testimony I provided on Wednesday will assist you in achieving the result and verdict in the case that you desire. ... At this point, any assistance that you can provide for me in the form of a letter of cooperation would be appreciated." (RX-260) The Division appropriately disclosed Poulson's letter to us.

Over the approximately five years since Poulson's conduct ended, the Division has not brought any action or proceeding charging Poulson or, to our knowledge, any of his associates with violating the federal securities laws. It may be that the Division plans to do so in the future. But to date the Division's only federal securities case arising from Poulson's conduct is the present proceeding charging an SDIRA custodian, which attended only one Poulson Russo educational seminar in April 2009, with "causing" Poulson's uncharged securities violations.

CONCLUSIONS OF LAW AND ARGUMENT

The SDIRA custodial industry is watching this proceeding closely. A decision imposing on custodians burdens that they do not presently have will necessitate changes to the structure and pricing of custodial services, resulting in serious disruption to the industry and increased fees for custodial customers. (Dea Tr. 1595; Desich Tr. 995-99)

Based on the record evidence summarized above, ETC respectfully requests a determination that it did not "cause" a fraud. A decision that ETC "caused" a fraud would severely hurt the company. "[S]everal of our larger [institutional] relationships, as a result of [simply the OIP], have either terminated their relationship with us and are transferring their business elsewhere or they're limiting our business by saying that we're ... not going to direct any new [business] to Equity Trust." And ETC's competitors are already using the OIP as a hand-out at trade shows to take away business. (Dea Tr. 1594-95; Desich Tr. 974-76)

ETC requests that the Initial Decision determine that (i) the Division has not carried its burden of proving the "cause" element for liability (Point I below); (ii) the Division has not carried its burden of proving the "primary violation" element (Point II); the Division has not carried its burden of proving the state-of-mind element (Point III); (iv) even if there were to be adverse findings, contrary to the record evidence, there would be no basis for monetary sanctions (Point IV); and (v) ETC's Constitutional defenses should be sustained (Point V).

I. THE DIVISION HAS NOT CARRIED ITS BURDEN OF PROVING THE "CAUSE" ELEMENT

"For 'causing' liability, three elements must be established," including that there be "an act or omission by the respondent that was a cause of the violation...." *Matter of Spring Hill Capital Markets, LLC*, 2015 WL 7730856 at *12, I.D. Rel. 919 (Nov. 30, 2015) (ALJ Foelak). ETC put this element at issue in its Answer, including in ¶¶47, 61, 62. For the reasons below, the Division has not carried its burden of proving this element.

None of ETC's custodial activities were a cause of the alleged primary securities violations committed by Taylor, Poulson and their respective affiliates. ETC's account-opening, investment processing, record-keeping and business marketing activities were completely unrelated to Taylor's and Poulson's alleged misrepresentations and misuse of funds lying at the heart of this case. ETC's communications and contacts with Taylor and Poulson, and with ETC's customers who invested with them, were no different from the communications and contacts ETC would have with any other party engaging in a transaction with an ETC account-holder. ETC was merely providing the same account custodial services offered by numerous other SDIRA custodians used by other individuals investing their SDIRA funds. The rendering of ETC's custodial services in the ordinary course of business fails to satisfy the requirement that there be a "sufficient nexus" to the violation in question, here, the wire and mail fraud committed by Taylor and Poulson. (RX-224, Carlson Expert Report, pp. 14-20)

A. The "Sufficient Nexus" Requirement

To find ETC liable for a "causing" violation under Securities Act §8A or Securities Exchange Act §21C, there must be a "sufficient nexus" between ETC's custodial services and securities law violations by Taylor and Poulson. In *Matter of Public Finance Consultants, Inc.*, 2005 WL 464865, I.D. Rel. 274 (Feb 25, 2005), *notice of finality as to relevant parties*, 2006 WL 2986867, SEC Rel. 33-8729 (Aug. 3, 2006), ALJ Kelly dismissed charges that a public authority's financial adviser (PFC) and its president (Fowler) caused violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act where the Division <u>failed to prove a "sufficient nexus"</u> between PFC and Fowler's conduct and the public authority's deception of purchasers of the authority's bonds:

> I conclude that the language in the [Authority's offering document] defined the limits of PFC and Fowler's engagement on the ... transaction in that <u>Fowler was under no duty to speak to the Authority about perceived disclosure</u>

deficiencies in the offering document. ... Congress has not forbidden such limiting language by statute and the Commission has not forbidden it by regulation, interpretive statement, or adjudicatory opinion. ... If the Authority had insisted that Fowler perform a broader range of duties, Fowler could have negotiated a higher fee or withdrawn from the engagement. [2005 WL 464865 at *53 (emphasis added)] ...

> I conclude that it was beyond the scope of PFC's and Fowler's engagement to advise the Authority about the accuracy, completeness, or fairness of the disclosure language in the [offering document]. ... Finally, I conclude that Fowler had no duty to speak on disclosure issues on July 8, 1998, or at any other time. The Division has failed to prove a sufficient nexus between Fowler's silence and the Authority's violations. On that basis, I conclude that PFC and Fowler were not shown to be "a cause" of the Authority's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

2005 WL 464865 at *55 (emphasis added). *See also Matter of Carley*, 2005 WL 1750288 at *50-51, I.D. Rel. 292 (July 18, 2005) (ALJ Kelly).

Similarly, in *Matter of Steinberg*, 2001 WL 1739153, I.D. Rel. 196 (Dec. 20, 2001), *dismissed by equally divided Commission*, 2005 WL 1584969, Rel. 2272 (July 6, 2005), ALJ Mahony rejected the argument that any act that contributes to a primary violation is a "cause" of that violation for purposes of a cease-and-desist order. Again based on the principle that the Division "must establish a sufficient nexus between the Respondents' alleged conduct and the underlying violations, if any," 2001 WL 1739153 at *39 (emphasis added), the ALJ dismissed charges against an audit partner for misrepresentations in a client's periodic reports:

> The Division further alleges that Steinberg caused Spectrum's violations by drafting and revising "inadequate" disclosures about these transactions in the footnotes to the financial statements in the First Quarter and Second Quarter Forms 10-Q. ... However, I conclude that Respondents did not cause these violations. ... His uncontradicted testimony, which I credit, is that he did not know until much later that the Apex and U.S. Robotics agreements were not signed in the quarters for which they were reported. ... I conclude, therefore, that the Division has failed to prove that Respondents caused Spectrum's violations of Section 13(a) of the Exchange Act and Rules 13a-13 and 12b-20 thereunder. Accordingly, the OIP must be dismissed. [2001 WL 1739153 at *43]

Cf. Berko v. SEC, 316 F.2d 137 (2d Cir. 1963), which interpreted the term "cause" in another section of the same statute, Exchange Act §15A(b)(4). There the charge was that the individual was "a cause" of his employer's broker-dealer deregistration. The court said that, while "an immediate or inducing" cause was not always required, "neither ... the Commission nor common sense suggests that the statutory requirement should be deemed to have been met by a demonstration merely that the salesman's conduct was to some degree a factor in the revocation of his employer's registration. More than this is required." 316 F.2d at 140.

B. ETC Not a "Cause" of Taylor's Violation

This Court need only review the Division's own allegations to see that ETC had nothing to do with Taylor's alleged securities law violations, let alone be a "cause" of those violations. As the Division pleads in OIP ¶26, the Commission's complaint filed in the District Court of the Northern District of Georgia (DX-5) sets forth the alleged fraudulent conduct committed by Taylor and which therefore constitute the primary violations in the instant proceeding. The relevant paragraphs in that complaint describe Taylor's violative conduct as follows:

> 17. Taylor and other City Capital employees advised investors, either in person or on the phone, that note proceeds would be used to acquire and operate the particular City Capital affiliate that issued the notes. Investors sometimes were provided offering documents describing the business that was issuing the notes, including financial reports on past and expected future operations. These documents were drafted by Taylor, or by others at his direction.
>
> 18. While some of the funds raised were used as promised, the majority of funds were spent on unrelated items, such as promotion for Taylor's book, consultants for Taylor's speaking engagements and public relations, studio time for his wife's music career, credit card bills, car payments, and rent for Taylor's New York apartment. The businesses typically floundered – or outright failed, as in the case of City Juice – as soon as City Capital acquired them. In fact, City Capital sold one laundry back to the original owner just one month after selling City Laundry promissory notes to a Houston investor. These details were not disclosed to investors.
>
> 19. Payments on the notes were sporadic at best, and City Capital rarely repaid any notes in full. Most commonly, City Capital pressed investors to roll their notes over for another year (or longer) by promising to increase the rate of return. The roll-over solicitations typically touted the supposed "great things" – usually of a socially conscious nature – City Capital was doing with the investor's money, which were all untrue. Investors who renewed were issued new promissory notes with the new term and interest rate. Any investor who resisted was subjected to an endless cycle of unreturned phone calls and emails, empty

> promises of imminent action, and claims that the investor had in fact already agreed to roll over his note. To the extent investors survived this gauntlet to still insist on repayment, any funds they received invariably came from new investor money.

The hearing record shows that ETC did not "cause" any of this specified Taylor conduct. In particular, ETC did not cause Taylor to tell investors how note proceeds would be used or what to tell his investors. ETC did not cause Taylor to spend note proceeds on his expenses or anything else. And ETC did not cause Taylor to fail to repay notes or to press investors to roll over their notes.

"The Division has failed to prove a sufficient nexus between" ETC's custodial work and Taylor's alleged securities law violations, and for this reason, ETC was "not shown to be 'a cause' of the ... violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act." *Matter of Public Finance Consultants, Inc.*, 2005 WL 464865 at *55. *Accord Matter of Steinberg*, 2001 WL 1739153 at *43 ("must establish a sufficient nexus between the Respondents' alleged conduct and the underlying violations").

C. ETC Not a "Cause" of Poulson's Violation

As with the Division's allegations with respect to Taylor's conduct, this Court need only review the Division's own allegations against Poulson to see that ETC had nothing to do with these alleged securities law violations, let alone be a "cause" of those violations. The Division never filed any enforcement action or proceeding against Poulson so there is no separate action setting forth the alleged securities law violations (let alone any document embodying a finding of Poulson's violation of federal securities laws). However, in OIP ¶50, the Division refers to the Justice Department's indictment of Poulson in the federal court in New Jersey (DX-269) to describe the specific conduct committed by Poulson and which therefore constitutes the primary violations in the instant proceeding. The relevant paragraphs in that indictment describe Poulson's violative conduct as follows:

> 3. From in or about July 2006 through in or about November 2011, in Gloucester County, in the District of New Jersey and elsewhere, the defendant RANDY POULSON, did knowingly and intentionally devise a scheme and artifice to defraud and to obtain money and property by means of materially false and fraudulent pretenses, representations, and promises, which scheme and artifice was in substance as set forth below.
>
> 4. It was part of the scheme and artifice that defendant RANDY POULSON offered to purchase real estate from distressed homeowners facing

foreclosure on their properties. POULSON falsely promised that he would pay the homeowners' mortgages in return for the sale of the properties.

5. It was further part of the scheme and artifice that defendant RANDY POULSON obtained the deeds to more than 25 distressed homeowners' residences, and caused the distressed homeowners to move out of their residences.

6. It was further part of the scheme and artifice that defendant RANDY POULSON stopped making the monthly mortgage payments on the distressed homeowners' mortgages, causing those mortgages to go into foreclosure without the homeowners' knowledge.

7. It was further part of the scheme and artifice that defendant RANDY POULSON, through Poulson Russo, gave speeches and seminars, monthly dinners, and various private tutorial sessions, purporting to teach real estate investing tips to individuals who paid fees to attend such events.

8. It was further part of the scheme and artifice that defendant RANDY POULSON solicited attendees at the seminars and other individuals, including members of the SJREIA [South Jersey Real Estate Investors Association], to invest in Equity Capital Investments. POULSON falsely claimed in the oral presentations and in written materials that investors' money would be used to fund the purchase, maintenance, and improvement of a specific residential property, including the closing costs of acquiring the property, a down payment, rehabilitation costs, and mortgage payments prior to finding a renter for the property.

9. It was further part of the scheme and artifice that defendant RANDY POULSON caused the investors to provide POULSON with money, both by wire transfer and by check, which POULSON caused to be deposited into the Equity Capital Investments Account.

10. It was further part of the scheme and artifice that defendant RANDY POULSON diverted much of the money that purportedly was going to be used to invest in the real estate properties to his personal use.

11. It was further part of the scheme and artifice that defendant RANDY POULSON periodically "repaid" investors using other investors' money to maintain the investors' confidence in the "investments."

The hearing record shows that ETC did not "cause" any of this conduct. The record shows that ETC did not cause Poulson to make false representations. ETC did not cause Poulson to misrepresent to distressed homeowners that he would make their mortgage payments in return for deeds on their properties, and then to stop making the mortgage payments. ETC did not cause Poulson to solicit investors with false promises that their funds would be used to acquire and develop specific properties. ETC did not cause Poulson to divert investor funds to his personal use. And ETC did not cause Poulson to repay certain investors to maintain other investors' confidence in the investments.

"The Division has failed to prove a sufficient nexus between" ETC's custodial work and Poulson's criminal conduct, and for this reason, ETC was "not shown to be 'a cause' of the ... violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act." *Matter of Public Finance Consultants, Inc.*, 2005 WL 464865 at *55. *Accord Matter of Steinberg*, 2001 WL 1739153 at *43 ("must establish a sufficient nexus between the Respondents' alleged conduct and the underlying violations").

II. THE DIVISION HAS NOT CARRIED ITS BURDEN OF PROVING THE "PRIMARY VIOLATION" ELEMENT

"For 'causing' liability, three elements must be established," including that there be "a primary violation...." *Matter of Spring Hill Capital Markets, LLC*, 2015 WL 7730856 at *12, I.D. Rel. 919 (Nov. 30, 2015) (ALJ Foelak). ETC put this element at issue in its Answer, including in ¶1, 25-29, 48-51. For the reasons below, the Division has not carried its burden of proving this element.

The Division charges that Taylor and Poulson each committed a primary violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act, which require fraudulent conduct in the offer or sale of securities. (OIP ¶5) Section 17(a)(2) makes it unlawful to obtain money or property by means of any untrue statement or omission of a material fact. Section 17(a)(3) makes it unlawful to "engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser."

Both Taylor and Poulson were indicted for mail and wire fraud, but not securities fraud. Taylor pled guilty, and Poulson pled not guilty initially but later changed his plea to guilty. While Taylor settled civil securities fraud charges filed by the Division, the settlement was entered into by written consent without any factual findings. (DX-6) Poulson has not been charged, either civilly or criminally, with securities fraud. Since ETC was not a party in these cases, none of these settled resolutions as to Taylor or Poulson are binding in the present proceeding.

A. Proof of Taylor's Primary Violation

ETC does not dispute that great financial harm came to those who trusted in and invested with Taylor. Nor does ETC dispute that Taylor and his cohorts deserve to have been punished for what they did. This does not necessarily mean that Taylor's offer and sale of notes during 2008 and 2009 (the period during which Taylor referred investors to ETC) constituted violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act. The hearing record paints a less "black-and-white" picture of Taylor, one suggesting that Taylor's initial intentions of creating "socially conscious" businesses were genuine but were later waylaid as a result of his mismanagement and overspending, until he realized – perhaps in mid-2010 or later (well after ETC stopped accepting any Taylor-related investments) – that the ship was sinking and he began grasping at straws like the sale of sweepstakes lottery machines.

One thing is clear. During 2008 and 2009, City Capital did not hide the financial challenges it was facing. As set forth in the proposed fact findings above, City Capital's annual and quarterly EDGAR filings publicly disclosed that it was significantly in debt, had notes coming due to earlier investors, had been losing money over several years, and that its continuing operations were being funded almost solely by borrowed funds coming from promissory notes it was issuing. City Capital's SEC filings reflected the growing number of outstanding promissory notes, referencing the principal amount, interest rate and maturity date in the notes to its consolidated audited financial statements in its annual reports. Those disclosures were drafted by an outside accountant, Lynda Keeton-Cardno, who had direct access to City Capital's financial records at year-end, and who testified at the hearing that she continues to this day to believe these financial disclosures on EDGAR were accurate.

The hearing record does not show by a preponderance of the evidence that Taylor was running a sham business during 2008-09, the relevant time period in this proceeding. The Division has not rebutted the testimony from a number of independent witnesses – each of whom had a big and continuing window into Taylor's operations – that City Capital and its affiliates were struggling start-ups with real aspirations of becoming profitable. As described in the proposed fact findings above, this included testimony from City Capital's outside accountant Keeton-Cardno, Taylor's outside attorney Robert Bovarnick, and Taylor's outside public relations consultant Raoul Davis. (Keeton-Cardno Tr. 1723-24; Bovarnick Tr. 1782, 1786-90; Davis Tr. 1672-75, 1686, 1699; RX-1, 10, 11) Indeed, sometime in mid-2010, Davis, who had helped promote Taylor's public image for years, had his then-new spouse invest with Taylor, using a different SDIRA custodian and not ETC. There came a point in or around mid-2010 when Taylor realized that these businesses would not survive, and rather than face that fact, engaged in a fraudulent scheme to raise additional funds by misrepresenting the use of those funds. But by that time ETC was far out of his picture, and Taylor was referring new SDIRA investors to two different SDIRA custodians, Sunwest Trust and American Pension Services.

Another fundamental question is whether Taylor's conduct was "in the offer or sale of any securities," as required in Securities Act §17(a). While throughout this case counsel have used the term "investors," Taylor and City Capital were actually offering promissory notes, not stock or bonds. The promissory notes offered by Taylor involved loans, with set payment dates and interest schedules. The notes included provisions outlining "late charges" if payments were missed, and reserving the right to "prepay" the note. (RX-183) The notes are "written in the manner of a loan," showing "'all the economic context of a temporary loan ..., not a permanent or semi-permanent source of capital investment with which to operate a major long-term ... venture.'" *Asset Protection Plans, Inc. v. Oppenheimer & Co., Inc.*, 2011 WL 2533839, at *3 (M.D. Fla. June 27, 2011) (citing *Singer v. Livoti*, 741 F.Supp. 1040, 1050 (S.D.N.Y. 1990)). Moreover, "the note was almost certainly short-term, the borrower had to re-pay the note in full even if [the business venture failed] and the note would not appreciate [if the business venture succeeded]." *Id.* (citing *United American Bank of Nashville v. Gunter*, 620 F.2d 1108, 1118 (5th Cir.1980)).

The leading case on whether a "note" is a security is *Reves v. Ernst & Young*, 494 U.S. 56 (1990), which adopted the so-called "family resemblance" test. Under the family resemblance test, notes were not securities if they resembled the types of notes on a list the Second Circuit had developed in earlier cases, including a "short-term note secured by a lien on a small business or some of its assets." 494 U.S. at 65. Here, as discussed in the proposed fact findings above, the notes at issue were either unsecured or secured by "the company," meaning whichever one of his startup companies was issuing the note. Accordingly, these short-term notes secured by one of Taylor's small companies resembled a specific item on the *Reves* family-resemblance list – a "short-term note secured by a lien on a small business." All of Taylor's notes indicate the economic context of a loan. Courts have found the motivations of the party offering the note to be determinative of the investment's character, because they "reveal the underlying economic reality of the transaction at issue." *Chao Xia Zhang-Kirkpatrick v. Layer Saver LLC*, 84 F. Supp.3d 757 (N.D. Ill. 2015).

Moreover, the *Reves* Court held that this family-resemblance list was "capable of expansion" and refinement, based on consideration of four enumerated factors. These factors include examination of whether the individual was "interested primarily in the profit the note is expected to generate," and whether the "plan of distribution" of the instrument involves "common trading for speculation or investment." 494 U.S. at 66. The Court noted that the financial instruments at issue in *Reves*, unlike the notes offered by Taylor, were "offered and sold to a broad segment of the public, and that is all we have held to be necessary to establish the 'common trading' in an instrument." *Id.* at 68.

Here, the notes were not marketed based on the lenders' expectations of "profits" being generated by Taylor's small business start-ups, but rather based on the lenders' desire to improve their return from their current investments and/or to engage in socially conscious investing. And based on the hearing testimony, Taylor's staff sold the notes in question in one-on-one meetings (or in private meetings between the prospective investor and small group of Taylor associates), in which a particular small business issuer was discussed and the proposed interest rate and terms stated, with no provision for the notes to be traded or to fluctuate in their pay-off amount or due date. This made the notes unlike those in *Reves*, where they were "offered and sold to a broad segment of the public," and where "one of the primary inducements" was a "variable" interest rate that made the ultimate pay-off amount uncertain, as well as a "demand" feature instead of a fixed term. 494 U.S. at 67-68. *See Bass v. Janney Montgomery Scott, Inc.*, 210 F.3d 577, 583-86 (6th Cir. 2000) (applying *Reves* four-factor "balancing formula" to find promissory note for loan to a business not to be a security); *SEC v. Life Partners, Inc.*, 87 F.3d 536, 548-49 (D.C. Cir. 1996) (promissory notes not securities under *Reves*, where IRA accounts made loans to fund purchases of viatical contracts); *Banco Espanol de Credito v. Security Pacific National Bank*, 973 F.2d 51, 54-56 (2d Cir. 1992) (loan participations analyzed as notes under *Reves* and found not to be securities).

B. Proof of Poulson's Primary Violation

As with Taylor, ETC does not dispute that great financial harm came to those who trusted in and invested with Poulson. Nor does ETC dispute that Poulson deserves to have been punished for what he did. However, once again the Division has failed to show by a preponderance of the evidence that Poulson was committing securities law violations by his conduct, which is a necessary element of the "causing" liability sought by the Division here. The Division has not rebutted the hearing evidence relating to the nature of Poulson's activities. As reflected in the testimony discussed in the proposed findings of fact above, Poulson was not engaged in the offer or sale of securities and therefore could not be found liable for a primary violation of Section 17(a)(2) or Section 17(a)(3).

Poulson was engaged in the business of buying, renting and selling houses. To finance a particular home purchase, he would obtain a loan from another individual. The record reflects that Poulson would approach (or be approached by) someone he knew from either SJREIA or his Poulson-Russo seminar audiences, on a one-on-one basis, to discuss the specific terms for this loan. With respect to all of the ETC SDIRA accounts, the loan was to Poulson personally, not to an entity. There is no evidence that any of ETC's customers were told that any of these loans would be pooled with loans from any other individuals to purchase any particular property. The purpose of the loan was simply to allow Poulson to buy a property, fix it up, and find a tenant willing to enter into a short-term lease with an option to buy the property. The personal loan would be evidenced by a note containing Poulson's personal promise to repay with fixed interest at the end of the stated short term, generally six months to a year. *Reves* held that "[i]f the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose ... the note is less sensibly described as a 'security.'" 494 U.S. at 66. *See also Asset Protection Plans, Inc. v. Oppenheimer & Co., Inc.*, 2011 WL 2533839, at *3 (M.D. Fla. June 27, 2011) (citing Martin Lipton & George A. Katz, "Notes" Are Not Always Securities, 30 Bus. Law. 763 (1974–75), at 766–67 ("if the note was issued to pay for ... a personal loan it is not a security") and 770 (characterizing as an "absurd result" the extension of the securities laws to a one-year personal loan)).

At the outset, Poulson reasonably believed that his contemplated real estate transaction would be successful and the loan repaid, based on his past real estate investment experience. However, following the 2008 real estate and financial market crisis, Poulson's tenants became unable to pay rent or get mortgage financing that would allow them to exercise their options to buy the properties. Then, when notes started coming due and he was facing increasing financial strain, Poulson sought extensions on these personal loans. While most of these loans eventually defaulted, to the extent that any of Poulson's conduct constituted securities fraud, it did so at a point in time beyond that relevant for ETC.

There also is considerable question whether Poulson's notes were securities under *Reves*. In enumerating the types of notes generally not considered to be securities, the Supreme Court in *Reves* included a "note secured by a mortgage on a home." 494 U.S. at 65. Here, each Poulson note stated that it would be secured by a specifically identified property. Each Poulson lender testifying at the hearing understood that the property in question already had at least a first mortgage. Moreover, these personal loans to Poulson for specific properties fit certain of the family-resemblance list "expansion" factors identified in *Reves*. Again, the lenders had no expectation that the investment represented by notes would "generate profit," but rather that they would be repaid with fixed interest at the end of the stated short term, with no expectation of "common trading" of any note or of any variable recovery upon pay-off. And referring to another of the Court's factors, such direct loans should have the "public expectation" of being only what they were, simple loans and not securities. 494 U.S. at 66. Again, whatever anyone may think of Poulson, the hearing record does not show by a preponderance of the evidence that there was fraudulent conduct during the relevant period in the offer or sale of a "security."

III. THE DIVISION HAS NOT CARRIED ITS BURDEN OF PROVING THE REQUIRED MENTAL STATE ELEMENT

In addition to proving the other elements addressed above, the Division has the burden of establishing that ETC "knew, or should have known, that [its] conduct would contribute to the violation." *Matter of Spring Hill Capital Markets, LLC*, 2015 WL 7730856 at *12, I.D. Rel. 919 (Nov. 30, 2015) (ALJ Foelak). ETC put this element at issue in its Answer, including in ¶¶4, 47, 61-62. As set forth below, the Division has not carried its burden of proving this element.

A. The *KPMG* Standard for Assessing Mental State

In administrative proceedings charging "causing" liability under Securities Act §8A (or its counterpart Securities Exchange Act §21C), proof of negligence is sufficient, but only where "a person is alleged to 'cause' a primary violation that does not require scienter." That is, negligence suffices only "[w]here ... the primary violations do not require culpability beyond negligence." *Matter of KPMG Peat Marwick LLP*, 54 SEC 1135, 2001 WL 47245 at *19, *20 (Jan. 19, 2001), *aff'd*, 289 F.3d 109, 120 (D.C. Cir. 2002). Thus, in a case where "scienter was an element of the primary violations that were the subject of the cease and desist order," the Commission applied a scienter standard in proceedings against an individual charged with causing the primary violations. *Howard v. SEC*, 376 F.3d 1136, 1141-42 (D.C. Cir. 2004).

The primary violations here were criminal mail and wire fraud where the required mental state was even higher than civil-based scienter. As previously noted, the Division charged Taylor with scienter-based civil violations and has not charged Poulson with any securities law violations, although one would assume that were it to charge Poulson at some point in the future, the alleged violations would be scienter-based charges. For this reason, under the rule laid down by the Commission in *KPMG* and affirmed by the D.C. Circuit, the Division should have to prove that ETC acted with scienter in causing primary securities law violations by Taylor and Poulson.

Scienter is "a mental state embracing intent to deceive, manipulate, or defraud," and involves "intentional or willful conduct designed to deceive or defraud investors." *Dirks v. SEC*, 463 U.S. 646, 664 n. 23 (1983), quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 193-94, n. 12, 199 (1976). It is "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977).

Tacitly acknowledging the absence of any scienter-based conduct by ETC, the Division seeks to side-step its duty to prove scienter by ETC. It essentially argues that the same conduct that constitutes a scienter-based primary violation (Securities Act §17(a)(1) for Taylor, and presumably wire and mail fraud for Poulson) also constitutes a negligence-based primary violation (Securities Act §§17(a)(2) and 17(a)(3)). That is, the Division argues that a primary violator acting intentionally or recklessly is, by the same conduct, implicitly also acting negligently. The Division's legal theory of liability in this case is based on the theory that it can slice up the same conduct by the primary violator and "pull out" the implicit negligence lurking within any intentional or reckless conduct, and thereby lighten its load in separately pursuing another person for "causing" that primary violation.

The Division's proposed approach utterly eviscerates the Commission's holding in *KPMG*, as reviewed and approved by the D.C. Circuit on appeal and in *Howard* and other cases. Such an approach would allow the Division to merely prove a secondary party's negligence to establish "causing" liability even though the primary violations were clearly scienter-based. This is on its face an indefensible and unjust prosecutorial position as well as an unreasonable interpretation of precedent. It is absolutely contrary to what the Commission said in *KPMG*, in which one of ETC's undersigned counsel was lead counsel for the Division.

However, as discussed below, even if the Division were permitted to depart from the *KPMG* standard and be required only to establish negligence by ETC, it cannot even meet this burden. Based on the language in its custodial account agreements and DOIs, its investment review policy and a reasonable understanding of all available public information, ETC acted reasonably in viewing Taylor and Poulson as respected business people and entrepreneurs. During the period of time that its customers were investing with them, ETC received no complaints about them from its customers. Indeed, it was only after conducting a voluntary investment review process, for reasons having nothing to do with the fraudulent conduct alleged to have been committed by them, that ETC determined not to take on additional accounts involving them – all years before law enforcement made any accusations against either. These are plainly not the acts of one seeking to "cause" a negligence-based securities law violation let alone criminal securities law violation. Such conduct plainly does not satisfy the "willful" or "reckless" mental state required to establish "causing" liability here, nor would it even rise to the level of negligence.

B. The Division Has Not Proved Scienter or Negligence by ETC in Allegedly Causing Taylor's Violations

Taylor presented himself to ETC and literally millions of people nationwide as an exceptional young man committed to what is often called "socially responsible investing" or "SRI," a concept which has grown rapidly in recent years, with SRI investments now said to account for "more than one out of every six dollars under professional management in the United States."[1] Taylor, the son of a Missouri pastor, sought to raise investments in his entities, including City Capital, to deploy in projects such as rehabilitating and constructing affordable housing, and supporting small businesses in challenged neighborhoods. In so doing, he also presented a personal history of success from humble beginnings to a string of business successes at a very early age.

Nationally prominent individuals and organizations endorsed Taylor and his ideas and presented him to audiences counted in the millions. On August 25, 2008, not long after the first ETC customers began investing with Taylor, the Democratic National Convention presented Taylor as a speaker on "socially conscious investment." (RX-25, 227) Throughout the period, ETC customers invested with Taylor, major media outlets profiled Taylor in a positive light, including ABC, CNN, Forbes, and NPR, while megachurches like New Birth Church in Atlanta and Joel Osteen's Lakewood Church in Houston, and numerous other churches, presented him to their congregations. (RX-30, 31, 36, 84, 85, 229, 241) In late June 2009 – just months before ETC conducted its review of Taylor described below – the National Conference on Volunteering, opened by First Lady Michelle Obama, featured Taylor with the CEOs of eBay and KPMG on a "Business Leaders for Change" panel moderated by CNN analyst and Harvard professor David Gergen. (RX-24, 228) Taylor's book "Creating Success From the Inside Out" was then a 250-page Wall Street Journal best-seller published by the venerable Wiley & Sons, a 200-year old technical publisher in New York. (DX-36, Taylor Dep. 207-08). Batt recounted how the television monitors that broadcast CNBC non-stop across ETC's sales floor one day presented to the entire ETC sales force an interview of Taylor emanating from the floor of the New York Stock Exchange. (Batt Tr. 440-41)

Irrespective of Taylor's prominence, ETC conducted a review – indeed one of its very first secondary reviews – of Taylor and City Capital beginning in September 2009. At the time ETC was beginning to conduct these new secondary reviews, City Capital had already exceeded the customer and dollar thresholds that automatically triggered that review. After beginning its review of City Capital on September 10, 2009, ETC noted that about half of the accounts it reviewed had full documentation, and the other half did not. ETC's research turned up no negative news articles, and no relevant federal or state decisions or securities violations. ETC confirmed that City Capital was a validly existing and active Nevada corporation. ETC's summary of its phone interview with Taylor as part of the review (DX-534) stated:

[1] "Report on US Sustainable, Responsible and Impact Investing Trends 2014," a report by US SIF – The Forum for Sustainable and Responsible Investment, p. 12, http://www.ussif.org/Files/Publications/SIF_Trends_14.F.ES.pdf. *See, e.g.*, "Buffett's Grandson Seeks Own Investment Route: Social Change," N.Y. Times, Nov. 21, 2015, p. B1 (Columbia professor forming company to deploy its investors' money in startups committed to projects like breeding crickets for ecologically sound animal feed, and a machine to convert humidity to drinking water).

... He does 60-90 seminars across the country every year on a variety of topics including economic empowerment, entrepreneurialism and business development. He always includes self-directed retirement investing in those seminars. He does not promote any particular investment in his seminars. They are strictly educational. His investors come as a result of the seminars and word of mouth. He has a huge following in the US and around the world. He has been on all the major networks and all the major financial networks. Requested missing documents. Recommend continuing.

The last DOI investment direction that ETC accepted for a Taylor customer was December 21, 2009. (DX-40, p. 14) On December 23, 2009, an ETC compliance representative phoned Taylor for additional information, and was told the requested information would be supplied. However, ETC put Taylor on "hold status" that day, subject to "clear[ing] up with operations the issue of 17 notes that have matured." ETC then opened no new accounts for investors planning to invest with Taylor, and formally put him on "DNP" (do not process) status on January 13, 2009. (DX-534, p. 2)

At this point, ETC had enough concern regarding City Capital's financial condition and unpaid matured notes to determine that new Taylor accounts would be "not administratively feasible." (DX-534, p. 2) However ETC did not have any information to contend or even suggest – either to customers who had previously invested with Taylor or to the public – that he might be perpetrating fraud or other violations. Customers agreed in their DOI investment direction forms that ETC would have "no duty or obligation to notify the undersigned with respect to any information, knowledge, irregularities or concerns of Custodian relating to my investment or my financial advisor, broker, agent, promoter or representative, except as to civil pleadings or court orders received by Custodian." (RX-97-99, p. 4, ¶12)

ETC could not reasonably have acted sooner. Like other professionals dealing with Taylor, it lacked a basis to accuse him of fraud. His outside certified public accountant reasonably believed into 2010 that he was running a young and striving business "that was attempting to do very good things in inner city cultures." (Keeton-Cardno Tr. 1723-24) His independent audit firm continued to sign his audited financials into 2010. (RX-1) His "outside general counsel" continued to represent him into 2010, including proposing a "settlement trust" to dozens of investors, without suspecting that Taylor was running a Ponzi scheme. (Bovarnick Tr. 1782, 1786-90; RX-10, 11) His outside media relations firm continued to represent him into 2011, and had his then-new spouse invest with Taylor in mid-2010. (Davis Tr. 1672-75, 1686, 1699) But unlike these other professionals who had regular and deep relationships with Taylor, ETC simply served as an SDIRA custodian for approximately 80 individuals (out of 130,000 ETC accounts) invested with Taylor.

C. The Division Has Not Proved Scienter or Negligence by ETC in Allegedly Causing Poulson's Violations

Poulson presented himself to ETC and many others as solid and responsible, and as particularly knowledgeable about real estate investing in his region. (RX-77) He was the president of his regional real estate investment association, the South Jersey Real Estate Investors Association (f/k/a South Jersey Investors), a chapter of the National Real Estate Investors Association. (RX-78-81) He regularly ran well-attended multi-day educational seminars for residential and commercial real estate investors in the South Jersey-Philadelphia area. (DX-746, 747, 761, 762)

ETC conducted a secondary review of Poulson in 2010, reflected in ETC's review documentation on Poulson, at a point when 18 ETC customers were invested with Poulson, actually just shy of the specified 20-customer threshold for such a review. (DX-256) The review showed that ETC had received DOI instruction forms from all 18 customers who had directed ETC to invest their SDIRA accounts with Poulson. However the review also showed that all of these customers had failed to send ETC one or more documents necessary to complete the files for their accounts. On November 15, 2010, ETC compliance representative Mary Juristy phoned Poulson and asked him to directly provide the customers' missing documentation, which Poulson agreed to do. Juristy noted that Poulson said "anything we need to keep file updated they are happy to provide." On November 30, 2010, Juristy sent Poulson a "detailed list of documents required for file." (DX-209) Over the next several months, Poulson began sending customer documentation to ETC, including on January 21, 2011, when he sent a portion of the needed documentation to ETC, and offered to send any additional documents still needed, including those "still with either my attorney or my title company." (DX-225)

Four months later, on May 11, 2011, ETC accepted its last DOI investment direction for a Poulson customer. (DX-41, p. 10) By July 11, 2011, an ETC re-review of Poulson showed that some of the then 26 customers had adequate documentation in their ETC files, but many files were still incomplete. On September 20, 2011, ETC staff recommended putting Poulson on "hold" status, meaning ETC would take no new accounts planning to invest with Poulson, based on continued missing documentation and the fact that by then a number of notes had matured without payment. ETC's staff simultaneously tried to contact Poulson for an explanation. (DX-256, p. 2) ETC's staff also obtained a 2011 LexisNexis profile of Poulson that disclosed a 2003 criminal case against a business associate. (DX-258, pp. 35-37)

ETC's review committee accepted the ETC staff's recommendation on November 17, 2011, and placed Poulson on "hold" status. (DX-256, p. 2) As with Taylor, any concerns ETC had at that point did not support charging Poulson with fraud or other violations, or suggesting such violations, to persons who had already invested their money with Poulson or others. And again, ETC's DOI investment direction forms provided that ETC would have "no duty or obligation to notify" the customer of "any information, knowledge, irregularities or concerns ..., except as to civil pleadings or court orders received by Custodian." (RX-97-99, p. 4 (¶12)

IV. NO BASIS FOR MONETARY SANCTIONS AGAINST ETC IN THIS MATTER

Even if there were to be a finding that ETC had "caused" a violation – which would be contrary to the record evidence – there would not be a basis to impose monetary sanctions.

A. No Basis for Disgorgement

The Division's only allegation concerning gain by ETC appears in OIP ¶22, which states that "Equity Trust charged fees to its customers in connection with its custodial accounts, including account opening fees and annual fees, usually in the hundreds of dollars per account per year." The Division knew that ETC received fees, and how those fees were calculated, based on its four-year subpoena-empowered investigation of this matter. Yet at the hearing, while contending that about 100 ETC customers had invested with either Taylor or Poulson, the Division did not choose to submit any evidence to show the amount of fees that ETC earned from these accounts. After a four-year investigation, and having also had the ability to subpoena evidence during the months leading up to the hearing, it is no answer for the Division to now say that it can plug the hole in its proof with a follow-on "accounting" proceeding, apparently to be conducted after an initial decision and any Commission review, to obtain discovery on and adjudicate the amount of fees paid.

Even if the Division had shown the total fees paid to ETC, this would not have sufficed. The Division would also have had to present evidence to show the portion of fees that it was asserting constituted ill-gotten gains. "[T]he Commission distinguishes between amounts earned through legitimate activities and those connected to violative activities, and it falls on the Division to show what a reasonable approximation of the ... fees was unjust enrichment." *Matter of Riad*, 2014 WL 1571348, at *32, I.D. Rel. 590 (Apr. 21, 2014) (ALJ Foelak). Where "the Division failed to meet its initial burden of presenting a 'reasonable approximation' of the profits connected to the violations," as in the present matter, "no disgorgement will be ordered." *Matter of Natural Blue Resources, Inc.*, , at *33, I.D. Rel. 863 (Aug. 18, 2015) (ALJ Foelak).

Appropriately, the Division has not even suggested that it seeks to hold ETC liable for proceeds obtained by Taylor or Poulson, and not by ETC. Courts only permit joint and several liability for disgorgement to trace assets and similar situations totally unlike anything here, for example: (i) where a defendant made unlawful profits in the account of another, *SEC v. Contorinis*, 743 F.3d 296, 303 (2d Cir. 2014); (ii) where a defendant transferred unlawful profits to a co-defendant, *SEC v. AbsoluteFuture.com*, 393 F.3d 94, 96-97 (2d Cir. 2004); (iii) where defendants "collaborated" on the scheme producing the unlawful profits, *SEC v. Pentagon Cap. Management PLC*, 725 F.3d 279, 288 (2d Cir. 2013); and (iv) where a defendant "controlled" another person making unlawful profits, Securities Exchange Act §20(a) (providing expressly that the controlling person shall be "liable jointly and severally").

Thus, there is no basis for holding ETC liable for disgorgement. The routine custodial fees ETC earned are not "ill-gotten gains" subject to disgorgement, and the Division has presented no evidence on such fees. And ETC certainly did not share in Taylor's and Poulson's profits, and . A "court may exercise its equitable power only over property causally related to" a violation of the federal securities laws. *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989); *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978); *SEC v. Jones*, 476 F. Supp. 2d 374, 386 (S.D.N.Y. 2007).

B. No Basis for a Penalty

Here there is simply no basis for assessing a penalty against ETC even if it could be shown that it caused a violation, which it did not. ETC did not engage in fraud and did not deliberately or recklessly disregard regulatory requirements. Taylor and Poulson harmed the individuals they deceived, but ETC did not harm their victims, nor was it unjustly enriched by their misconduct. ETC has complied with the law and regularly received satisfactory ratings in its regular examinations by state regulators. Deterrence should not be considered in the Division's first-ever case against an SDIRA custodian acting within the scope of its limited responsibilities, as defined by law and contract. *Matter of Spring Hill Capital Markets, LLC*, 2015 WL 7730856 at *19, I.D. Rel. 919 (Nov. 30, 2015) (ALJ Foelak). Of course, ETC's determination to defend this proceeding is not a factor to be considered with respect to any penalty. *E.g. SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1229 (D.C. Cir. 1989); *SEC v. Todd*, No. 03CV2230, 2007 WL 1574756, at *17 (S.D. Cal. May 30, 2007) (citation omitted), *aff'd in part and rev'd in part on other grounds*, 642 F.3d 1207 (9th Cir. 2011).

To assess any civil monetary penalty, it is necessary to "determine how many violations occurred and how many violations are attributable to each person, as the statute instructs." And for a second or third tier penalty, it would further be necessary to "find" that ETC aided and abetted or caused violations of Securities Act §17(a)(2) and (3) with "deliberate or reckless disregard" of the statutory requirements. *Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012) ("SEC must provide some meaningful explanation for imposing sanctions"). *Accord, Rockies Fund,* Inc. *v. SEC*, 428 F.3d 1088, 1099 (D.C. Cir. 2005) ("SEC's analysis was not just superficial; it was nonexistent" and "arbitrarily and capriciously imposed" penalties).

If there were to be a penalty – which there plainly should not be for the reasons stated above – it should be limited to one course of action. *E.g. Matter of Havanich*, 2016 WL 25746, at *11, I.D. Rel. 935 (Jan. 4, 2016) (ALJ Foelak); *Matter of Natural Blue Resources, Inc.*, , at *33, I.D. Rel. 863 (Aug. 18, 2015) (ALJ Foelak); *Matter of Riad*, 2014 WL 1571348, at *34, I.D. Rel. 590 (Apr. 21, 2014) (ALJ Foelak).

V. ETC's CONSTITUTIONAL DEFENSES

Respondent hereby asserts and preserves the Constitutional defenses stated in its Answer. Following the Dodd-Frank amendments, Pub. L. 111-203, § 929P(a) (2010), the Commission can now commence a litigated case against an unregistered person or entity either in federal court or through an administrative proceeding and get essentially the same relief in either forum. After accepting the Division's recommendation for enforcement action, the Commission must not select a forum that will give the Division a procedural or other advantage, and it should not force an unregistered party into the administrative forum over that party's objection.

A. Fifth Amendment Right to Due Process

ETC objects to the administrative forum because it benefits the Division and prejudices ETC for the following reasons, among others: **(i)** Although the Division has been able to take as many discovery depositions as it chose during its multi-year investigation, the Rules of Practice have denied ETC the opportunity to take any discovery depositions at all. **(ii)** Although the Division has already obtained responses to its requests for extensive document productions and other discovery, during investigations by the Fort Worth and New York offices, the Rules of Practice unfairly limit ETC's third-party discovery to limited-scope subpoenas during a short time span. **(iii)** The Rules of Practice lack rules of evidence, and thus result in a record that necessarily includes extensive amounts of hearsay evidence gathered by the Division during its lengthy investigation, without allowing ETC to test that evidence through cross-examination or otherwise. **(iv)** While two offices of the Division have had years to prepare its case with investigative subpoenas, ETC must proceed to hearing in just a few months under Rule 360(a)(2). **(v)** After being rushed to hearing, ETC will have to wait years for the Commission's *de novo* review of the initial decision, if review is sought by either side on any issue, before the Commission issues its "final decision," far longer than in federal district court.

B. Seventh Amendment Right to Jury Trial

ETC objects that the administrative forum denies it a jury trial. A defendant should have the same Seventh Amendment right to demand a jury that the Commission and its staff have. However by allowing the Commission to pursue defendants for virtually the same relief in federal court or in administrative proceedings, the Dodd-Frank amendments have unwittingly upended this Constitutional balance in the following way. In situations where the Commission and its staff want a jury trial, the Commission always gets a jury by proceeding in federal court and filing a jury demand. However where the Commission and its staff do not want a jury, the Commission now has the opportunity to prevent the case from being jury-tried by instituting a non-jury administrative proceeding for virtually the same relief. This effectively means that the Commission and its staff get total control over whether there is a jury in its enforcement cases, regardless of whether, as here, the defendant wants a jury.

Such an imbalance in access to the jury process is unfair and offends both the Fifth and the Seventh Amendments. To be clear, the question is not whether Congress can commit certain types of civil law enforcement to the non-jury administrative forum. Rather, the question is whether, in cases where an agency has power to choose the forum, it can routinely do so in a way that has the effect of reposing only in the agency the right to demand a jury – and to deny a jury to the defendant whenever the Commission does not want a jury. *See Tull v. U.S.*, 481 U.S. 412 (1987) (Seventh Amendment guarantees defendant right to jury trial in civil action where government seeks civil penalties); *Atlas Roofing v. Occupational Safety and Health Review Commission*, 430 U.S. 442 (1977) (no right to jury trial in administrative proceedings).

C. Article II Requirements for Executive Power and Appointments

Article II, Section 1, provides that the "executive power shall be vested in" the President. Article II, Section 2, provides that the President "shall appoint ... officers," and that Congress may allow "heads of departments" to appoint "inferior officers." Administrative Law Judges ("ALJs") are executive branch "officers" within the meaning of Article II. The SEC is a "department" of the United States, and the SEC Commissioners collectively function as the "head" of the "department" with authority to appoint such "officers" as Congress authorizes through legislation.

Such officers – charged with executing the laws, a power vested by the Constitution solely in the President – may not be separated from Presidential supervision and removal by more than one layer of tenure protection. In particular, if an officer can be removed from office only for good cause, then the decision to remove than officer cannot be vested in another official who also enjoys good-cause tenure. Yet SEC ALJs have not been appointed by the SEC Commissioners, and SEC ALJs enjoy at least two layers of tenure protection. SEC administrative proceedings therefore violate Article II of the U.S. Constitution.

CONCLUSION

The Division has not carried its burden of proving that ETC "caused" the criminals Taylor and Poulson to commit their violations. For the foregoing reasons, this proceeding should be dismissed.

Dated: January 28, 2016

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CERTIFICATE OF SERVICE AND FILING

Pursuant to Rule 150(c)(2), I certify that on January 28, 2016, I caused the foregoing to be sent: **(1)** by **email and US Mail** directed to Honorable Carol Fox Foelak, Administrative Law Judge, Securities and Exchange Commission, 100 F Street NE, Washington DC 20549-2557, and alj@sec.gov; **(2)** by **email and US Mail** directed to William Miller, OALJ Attorney-Advisor, Securities and Exchange Commission, 100 F Street NE, Washington DC 20549-2557, and millerwi@sec.gov; and **(3)** by **email and US Mail** directed to David Stoelting, Luke M. Fitzgerald, and Andrew Dean, New York Regional Office, Securities and Exchange Commission, 200 Vesey St., Suite 400, New York NY 10281, and StoeltingD@sec.gov, FitzgeraldL@sec.gov, and DeanAn@sec.gov. The **original and 3 copies** are being filed with the Office of the Secretary, Securities and Exchange Commission, 100 F Street NE, Washington DC 20549-1090.

/s/ Brian M. Walsh