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U.S. SECURITIES AND EXCHANGE COMMISSION

Matter of

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

Respondent.

RESPONDENT'S POST-HEARING REPLY BRIEF

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Respondent Equity Trust Company ("ETC") files this post-hearing reply brief in response to the Division's opening post-hearing brief, containing its proposed findings and conclusions ("Div. Br."), and in further support of ETC's opening post-hearing brief, containing its proposed findings and conclusions ("ETC Br.").

The Division, in its first-ever case against a self-directed individual retirement account ("SDIRA") custodian, has attempted to proclaim new duties and obligations for such custodians that are inconsistent with longstanding guidance from the Commission, the federal courts and other authorities, and in direct conflict with the agreements entered into between the custodians and their customers. (**Point I** below) The Division has not carried its burden of proving that ETC "caused" an antifraud violation of the Securities Act by Ephren Taylor ("Taylor") and his related entities. (**Point II** below) The Division has likewise not carried its burden of proving that ETC "caused" an antifraud violation of the Securities Act by Randy Poulson ("Poulson") and his related entities. (**Point III** below) Finally, even if the Division had hypothetically proven that ETC caused such a violation – which the Division has failed to do – it has not established a basis for the relief it seeks. (**Point IV** below)

I. THE DIVISION MISSTATES THE DUTIES OF AN SDIRA CUSTODIAN

The Division seeks to hold ETC and other SDIRA custodians to a standard articulated by Pittsburgh attorney William Ries, whose credentials show absolutely no experience in the SDIRA custodial industry or familiarity with the laws, regulations or agreements governing an SDIRA custodian's business or operations. (**Point A** below) In contrast, federal courts as well as regulatory organizations and individuals with meaningful experience, expertise and authority, have expressed a sharply different view of the duties of SDIRA custodians. (**Point B** below)

And ETC, consistent with the rulings by these federal courts and the pronouncements of these authorities, has appropriately defined its custodial duties by contract. **(Point C** below) Finally, considering the limited role of an SDIRA custodian, the Division's citations to cases finding "causing" liability are inapposite or support ETC's position. **(Point D** below)

A. Views of Attorney William Ries

In stating the duties of an SDIRA custodian, the Division relies on the opinion of Pittsburgh attorney William Ries, a partner in the Tucker Arensberg law firm and an adjunct professor at his alma mater, Duquesne Law School. (Div. Br. pp. 9-10) Ries provides the details of his professional training and experience over several pages at the beginning of his report and in his attached curriculum vitae. Significantly Ries points the Court to absolutely no experience advising SDIRA custodians or others with respect to SDIRA custodians, or in rendering any prior expert testimony regarding the duties of an SDIRA custodian. He states his experience as a banking lawyer, with no experience dealing with SDIRA custodians. (DX-39)

Ries, a Pennsylvania lawyer, based his views of an SDIRA custodian's duties on the laws of South Dakota, where ETC is chartered: "South Dakota law authorizes a trust company to act as a custodian. Acting as a custodian is considered to be acting in a fiduciary capacity under South Dakota law. Therefore, when acting as custodian, Equity Trust is subject to certain fiduciary duties." (DX-39, ¶15) However, the Division's other expert Tom Simmons, a South Dakota estates and trusts professor – also lacking any experience dealing with SDIRA custodians – opined that South Dakota law does not apply here "at all": "[T]he ETC Account Agreements state that the parties did not intend for South Dakota law to apply at all," and based on "the parties' intent to be governed by Ohio, not South Dakota, law," it would "be inconsistent with that intent for ... South Dakota law to govern...." (DX-836, pp. 2-3)

Notwithstanding the above-noted contradicting expert testimony, the Division, relying on the report of Ries, asserts that an SDIRA custodian has the following specific duties: **(i)** The custodian must "ensur[e] that proper documentation is obtained" pertaining to the custodied asset. (Div. Br. p. 12) **(ii)** The custodian must "obtain relevant information concerning" the asset, and "deliver any material information concerning" the asset to the customer. (Div. Br. p. 13) **(iii)** The custodian must "periodically review" the asset, "weigh risk" associated with the asset, and advise the customer of "any issues" that "may subject an asset to significant risk." (Div. Br. p. 16) **(iv)** The custodian must "not promote or endorse" an investment. (Div. Br. p. 17) **(v)** If any statement or conduct by an employee of a custodian could be interpreted as investment advice, this automatically voids the custodian's entire account agreement and makes it a full-blown "fiduciary" in all respects. (Div. Br. p. 18) **(vi)** The custodian's acceptance of referrals, if it amounts to a "relationship," would create a "conflict of interest" with the customer being referred. (Div. Br. pp. 19-20) **(vii)** The custodian "should maintain the privacy of" customer account information. (Div. Br. pp. 20-21) **(viii)** The custodian must have policies and procedures that "ensure" that the asset is "properly administered," including an "asset review process." (Div. Br. p. 21) Ries' report also states that an SDIRA custodian has the specific duty

(i) to train sales staff on identifying potential conflicts of interest with "referral sources"; **(ii)** to "periodically review" a customer's investment to ensure it is not in default; and **(iii)** to advise its custodial customer if it becomes "aware" that a customer's investment is subject to a "significant risk." (DX-39, ¶¶28, 39)

This formulation of an SDIRA custodian's duties is unreasonable on its face. As the Commission has noted, an SDIRA "permits investment in a broader set of assets than is permitted by most IRA custodians," including such "alternative" assets as "real estate, promissory notes, tax lien certificates, and private placement securities." (RX-46, "*SEC Investor Alert: Self-Directed IRAs and the Risk of Fraud*," p. 1). SDIRA assets often include residential and commercial properties, all unique in characteristics and investment risks, located across all fifty states and foreign countries. SDIRA assets can also include a wide variety of other unique investments – ranging from promissory notes with differing terms and credit risks to "hard" assets like cell phone towers, machinery, livestock, etc. – also in geographically diverse locations. There is simply no way an SDIRA custodian can assume the responsibilities suggested by Ries for such assets without charging astronomical fees that would quickly render SDIRAs not feasible for most investors presently using them.

B. Recognized Authorities' Disagreement With Ries' Conclusions

The Division's opening brief neglects to mention the fact that all other authorities take a strikingly contrary view of an SDIRA custodian's duties from that offered by Ries. We invite the Court's attention to our opening brief for a full statement of what these authorities say. (ETC Br. 2-5) To illustrate the difference between their views and those of Attorney Ries, we will highlight the following:

(1) Securities and Exchange Commission. The Commission expressed its understanding of SDIRA custodians' duties, and the custom and practice among SDIRA custodians, when it officially advised the nation's investors 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).

(2) North American Securities Administrators Association. In a December 2014 press release, the Washington State Securities Director, speaking as NASAA's president, stated: **(i)** that SDIRA custodians have "limited duties to investors"; and **(ii)** that their "sole responsibility is to report information to the IRS and from the issuer to the investor." (RX-263; Mirko Tr. 1844-45) NASAA's accompanying alert, again reflecting industry custom and practice, told investors 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 promoters"; **(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))

(3) United States District Courts. In *Hines v. Fiserv, Inc.*, 2010 WL 1249838 (M.D. Fla. March 25, 2010), the court interpreted what Congress provided in Section 408(h) of the Internal Revenue Code, which states that an IRA custodial account "shall be treated as a trust" if the assets are held by a bank or other approved custodian, and if the custodial account would qualify under another provision as an IRA "except for the fact that it is not a trust." The *Hines* court concluded that "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." 2010 WL 1249838 at *3.

In *Mandelbaum v. Fiserv, Inc.*, 787 F.Supp.2d 1226 (D. Colo. 2011), investors brought a class action against their SDIRA custodian after being wiped out in the Madoff Ponzi scheme. Similar to the Division in the present matter, the investors charged that the custodian, among other things: "failed to verify whether and how Bernard Madoff continued to hold the assets"; failed to keep track of, maintain custody over, and maintain title to the assets; "knew from past experience with other questionable funds" that there was risk; "enabled Madoff's theft" by "lack of oversight"; "engaged in a *quid pro quo* arrangement with Madoff" that led it "to disregard various red flags concerning Madoff's fraudulent activities"; and "obtained information about the questionable nature of Madoff's operations." 787 F.Supp.2d at 1233. In dismissing, the court relied on account agreements highly similar to those in the present matter and said:

> ... Although Plaintiffs allege that "Madoff required IRA accounts to be handled through Fiserv," ... the Plaintiffs, not Fiserv or Defendants, made the initial decision to invest their funds with Madoff. Therefore, although Fiserv had a monopoly on IRA investments with Madoff, the Court finds that such monopoly, alone, does not provide a basis to invalidate the at-issue exculpatory provisions ...
>
> The Court finds that Defendants have fulfilled all their obligations as delineated in the Agreements: they provided account statements that contained the information from BMIS [Madoff's firm], which they had no obligation to verify or audit; at Plaintiffs' direction, they transferred assets to BMIS; and they had no contractual obligation to prevent Madoff or BMIS from commingling Plaintiffs' assets. ...

> Plaintiffs' claims also fail to the extent they are premised on a failure to exercise control over, preserve and maintain, and avoid commingling of the trust assets. Plaintiffs complain that Defendants lost control over their assets when they were directed to Madoff for investment purposes. However, Defendants transferred such assets, at the express direction of Plaintiffs. ...

787 F.Supp.2d at 1241-42, 1243. So the federal courts, like the SEC and NASAA, recognize that SDIRA custodians' duties, and the custom and practice among SDIRA custodians, are very different from the views of Attorney Ries, the Division's expert. Additionally, the Division's witness Scott Kelly, Deputy Director of Trusts for the South Dakota Department of Banking, who oversees his state's chartered bank trust departments and trust companies like ETC, made not a single reference in his testimony to ETC being a fiduciary. (S. Kelly Tr. 1156-1200)

(4) Expert With Actual SDIRA Custodian Experience. Unlike the Division's experts who have absolutely no SDIRA experience at all, ETC presented a report (RX-222), a rebuttal report (RX-223) and testimony from Terry Prendergast, who has worked extensively with SDIRA custodians and in the SDIRA custodial industry. Prendergast helped all six South Dakota-chartered SDIRA custodians obtain their charters (with the single exception of ETC), has worked with over half of South Dakota's 80 non-depository trust companies, and serves each year on the South Dakota governor's trust administration task force. (RX-222, pp. 1-2)

Based on ETC's custodial account agreement, Prendergast's opinion is that, under South Dakota statutory and case law, ETC as an SDIRA custodian **(i)** had "no duty to review or modify any direction from" an SDIRA custodial customer; **(ii)** was "not liable under South Dakota law, either individually or as a fiduciary, for any loss resulting from compliance with a direction of the custodial account" customer; **(iii)** "had no duty to perform investment or suitability reviews, inquiries or investigation"; **(iv)** would not, by communicating about investments, be deemed to give "an undertaking to monitor such investments" or to assume "the duty to do so"; **(v)** was "relieved of any duty to communicate with, warn, or apprise any party concerning instances" where it "may have exercised its own discretion differently" than the customer; **(vi)** did not, by carrying out the customer's investment directions, give an undertaking "to monitor, participate, or otherwise take any fiduciary responsibility for" the customer's directions. (RX-222, pp. 14-15) Prendergast opined:

> Therefore, in my opinion, under South Dakota law, because Equity Trust Company had no duty to custodial account owners under the circumstances outlined above, it could not be and was not negligent in the assumed acts or omissions as set forth in the statement of assumed facts [tracking the OIP]. If the custodial agreement does not require a custodian (a) to obtain all documents reflecting an investment that are not furnished by a custodial account owner as required in the agreement, or (b) to notify a custodial account owner of matured

> and unpaid promissory notes held in a custodial account, the custodian has no duty to the custodial account owner to do so under South Dakota law.

(RX-222, p. 15) Alternatively, as the Division's experts Ries and Simmons disagree with each other over whether South Dakota or Ohio law applies, our opening brief cites the Ohio statute that resembles the South Dakota statute cited by Prendergast. That 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.

C. ETC's Duties Are Defined by Contract

Consistent with the authorities discussed above, ETC contracted with customers to provide certain custodial functions but deliberately excluded many other services and duties – all in a manner that was typical in the SDIRA industry, and that allowed ETC to set its fees at a small fraction of what they would be if it had to assume the tasks and duties the Division is proposing. These contractual limitations are quoted and discussed in detail with record cites in our opening brief. (ETC Br. 5-9)

Among other things, in the DOI form that accompanied each investment, the customer stipulated and agreed that: **(i)** "Equity Trust Company has not solicited, recommended or sold this investment to the retirement account owner." **(ii)** "Equity Trust Company does not endorse this investment." **(iii)** "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." **(iv)** "I agree that the custodian is not a fiduciary for my account." **(v)** "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." These investment-specific stipulations in each DOI also reflect the terms of the customer's custodial account agreement.

The Division argues that these binding contractual provisions on which the SDIRA industry is based – all SDIRA custodians, not just ETC – should be ignored whenever the custodian "does not act as a passive custodian." First, the Division does not cite a single case, statute, regulation or other authority, much less a securities case, for this proposition. The Ohio appellate court's ruling on ETC's motion to dismiss filed in *Bentley v. Equity Trust Co.*, 2015 WL 725496 (Ohio App. Nov. 16, 2015), did not turn on whether ETC was passive but merely on whether Ohio state law allowed contractual limitations on tort liability. The other case cited by the Division in purported support of that proposition, *Mid-Ohio Securities Corp. v. Estate of Burns,* 790 F. Supp. 2d 1263 (D. Nev. 2011) was merely a ruling without written explanation or rationale on certain procedural arguments raised by ETC in connection with a motion to vacate a

FINRA arbitration ruling. Second, the Division's theory is unworkable. The Division does not and cannot parse out, under its theory, just how "un-passive" a custodian would have to be to void contractual provisions. Would standing and smiling when you are recognized in a large audience be enough? How about providing training on how SDIRAs work? Will such actions void entire contracts, or just portions, or just in some circumstances? The Division does not explain.

More to the point, courts have held that SDIRA custodians' exculpatory provisions of the type in ETC's agreements do not violate public policy. As the court said in *Mandelbaum v. Fiserv, Inc.*, 787 F.Supp.2d 1226, 1241-42 (D. Colo. 2011), involving the Madoff Ponzi scheme, "many choices exist for consumers ... who seek IRA services. ... [T]he availability of choice in the market with respect to the person or entity to perform such service supports a finding that the exculpatory provisions should not be rendered void as against public policy." *See also Hines v. Fiserv, Inc.*, 2010 WL 1249838 (M.D. Fla. Mar. 25, 2010), a claim against an SDIRA custodian relating to the Pearlman Ponzi scheme, in which the court upheld contractual provisions disclaiming fiduciary and other duties. In so doing, the court also noted that the FDIC's Trust Examination Manual, referred to by the Division and Ries, "expressly provides that the custodians of self-directed accounts ... have no responsibilities beyond the provisions of the governing account instrument." *Id.* at *5.

D. The Division's "Causing" Citations Are Inapposite or Support ETC

Here ETC was an outside service provider to customers who stipulated – in bold print right above their signatures on every DOI form – that they "alone" were "responsible for the selection, due diligence, management review and retention" of their Taylor investment, and that ETC was "not a fiduciary for my account." ETC had no control over Taylor or his activities, and for this reason the authorities the Division cites on "causing" liability are inapposite. (Division Br. p. 165) For this reason, none of the decisions cited in the Division's opening brief support a finding of "causation" liability against ETC.

The Division's principal citation (Div. Br. 165), the Commission's decision in *Matter of McConville*, 2005 WL 1560276, Rel. 34-51950 (June 30, 2005), *petn. denied*, 465 F.3d 780 (7th Cir. 2006), considered whether the chief financial officer of an SEC-reporting company, in addition to directly violating Exchange Act §10(b) and Rule 10b-5, was also a "cause" of her company's failure to maintain accurate books and records, failure to maintain adequate internal accounting controls, and failure to file complete and accurate periodic reports. As chief financial officer, McConville supervised the company's finance department, and with the controller was responsible for its periodic filings. The Commission found that, as the person responsible for the company's financial records, SEC reports and accounting controls, CFO McConville knew or was reckless in not knowing the company committed these primary violations. The facts in *McConville* bear no resemblance to the facts here. No one from ETC was in a position of responsibility, authority or control vis-à-vis Taylor or Poulson or their various entities. ETC had a pinhole-sized view of Taylor's and Poulson's operations, and there is nothing in the record

evidence that ETC or its staff played a role in how Taylor and Poulson conducted their affairs. ETC had no involvement in Taylor's and Poulson's alleged primary violations, and certainly no relationship comparable to McConville's involvement in her company's reporting, controls, and books and records.

The Commission's decision in *Matter of Chan*, 2002 WL 507022 (Apr. 4, 2002), also cited by the Division (Div. Br. p. 165), is similarly inapposite as it involved a corporate officer's liability for causing his company's anti-fraud violations due to the officer's failure to correct known misstatements in the company's securities offering documents and securities purchase agreements that he reviewed for accuracy and completeness. The Commission found that Chan, as the company's corporate secretary, "had personal knowledge of facts contradicting the statements in the PPM and securities purchase agreement" and that "[a]s a corporate officer, Chan was responsible for ensuring that [his company's] offering documents disclosed material facts of which he had knowledge." *Chan* merely stands for the uncontroversial proposition that a corporate officer may "cause" his company's primary liability for offering fraud when that officer holds responsibility for reviewing the accuracy and completeness of disclosures in the company's offering documents. Here ETC, as is the custom for SDIRA custodians, expressly disavowed any responsibility to investigate or provide advice regarding a customer's investment and, as admitted by the Division, had no knowledge of the primary frauds.

The Division, arguing that "cause" does not always mean "an immediate or inducing cause" (Div. Br. p. 165), cites *R.H. Johnson & Co. v SEC*, 198 F.2d 690 (2d Cir. 1952) – involving a different statute, Exchange Act §15A, and decided four decades before the 1990 Remedies Act added "causing" liability in Securities Act §8A. The Court found "ample evidence" that the individual respondent there was in control of the brokerage firm and caused its expulsion from an SRO because "he had complete control of all persons in the organization ... and ... signally failed to provide any adequate supervision although his extensive control put upon him that responsibility." This is hardly the situation here where no one from ETC had any control over or responsibility for the activities of Taylor or Poulson.

The Division, arguing that "causing" liability may exist where there are other equal or greater causes, cites *Harrison Securities, Inc.*, 2004 WL 2109230, I.D. Rel. 256 (Sept. 21, 2004) (Div. Br. p. 165), in which Judge Kelly found that the CEO (and sole shareholder) and the FINOP of a broker-dealer were each a "cause" of the its primary violations, based on overwhelming evidence of their own directly culpable conduct tied directed to the primary violations. The Division neglects to note Judge Kelly's approval of Judge Mahony's decision in *Matter of Steinberg*, 2001 WL 1739153, I.D. Rel. 196 (Dec. 20, 2001), *dism. by equally divided Comm.*, 2005 WL 1584969 (July 6, 2005), cited in our opening brief, rejecting the Division's argument that any act that contributes to a primary violation is a "cause" of that violation, and requiring the Division to establish "a sufficient nexus between the Respondents' alleged conduct and the underlying violations." Here the Division totally fails to establish the nexus between ETC's provision of custodial services and the alleged offering fraud committed by Taylor and Poulson.

II. ETC DID NOT "CAUSE" A TAYLOR VIOLATION

The Division has not carried its burden of proving that ETC "caused" a Taylor securities fraud violation because, as discussed in detail in our opening brief (ETC Br. pp. 45-60):

- There is no "causal nexus" between ETC's actions and a Taylor violation. Even if ETC had provided exceptionally poor service as an SDIRA custodian, which it plainly did not, this would still not make it a "cause" of an issuer's criminal securities fraud. *Matter of Steinberg*, 2001 WL 1739153, I.D. Rel. 196 (Dec. 20, 2001), *dism. by equally divided Comm.*, 2005 WL 1584969 (July 6, 2005) ("must establish a sufficient nexus between the Respondent's alleged conduct and the underlying violations, if any"); *Matter of Public Finance Consultants, Inc.*, 2005 WL 464865, I.D. Rel. 274 (Feb. 25, 2005) ("failed to prove a sufficient nexus," and thus "not shown to be 'a cause'"). *See also Matter of Trepp*, 1997 WL 469718, at *21-22, I.D. Rel. 115 (Aug. 18, 1997), *petn. dism.*, 1999 WL 753922 (Sept. 24, 1999) (ALJ Foelak) (Broker-dealer's head bond trader carried out program for corporate client; "Because of his remoteness in the chain of causation, it is concluded ... that he was not a 'cause' of Reliance's [Securities Act §17(a)(2)] violation within the meaning of Securities Act Section 8A").

- With the alleged underlying violation being criminal, the Commission requires a showing of at least scienter for "causing" liability. *Matter of KPMG Peat Marwick LLP*, 2001 WL 34138819 (Jan. 19, 2001), *aff'd*, 289 F.3d 109 (D.C. Cir. 2002). The Division cites no authority for its lesser-included-offense approach of charging ETC with causing only the non-scienter portions of Taylor's violation, and this is contrary to what the Commission said in *KPMG*. In any event, the Division has failed to show that ETC acted with scienter or even negligence with respect to Taylor's fraud.

- City Capital's recurring losses and debt burden were fully disclosed in the audited and unaudited financial statements included in City Capital's periodic reports on EDGAR. Further, City Capital's outside PCAOB-registered accountant testified at the hearing that City Capital's financial reporting was accurate through mid-2010 and that its business was viable till then. For this reason, if the loans investors made to Taylor's entities are held to be securities, any underlying Taylor fraud would likely have developed only some time *after* ETC took on its last Taylor account in December 2009. (Keeton-Cardno Tr. 1721-23, 1727-28; RX-1, 2, 6; DX-537)

As discussed below, rather than address the elements of "causing" liability, the Division instead focuses on topics that are simply not relevant to a "causing" determination under Securities Act §8A – for example, supposed investor reliance on ETC's "involvement," SDIRA marketing activities, and internal reviews of customer investments. While such topics are irrelevant to a "causation" liability analysis, we will rebut these Division arguments and

demonstrate why it has not carried its burden of proof: **(i)** The Division relies heavily on the testimony of six Taylor investors, but their hearing testimony and contemporaneous documents instead show ETC acting in the background as an SDIRA custodial service provider, not as a promoter. **(Point A** below) **(ii)** The particular activities and events that the Division cites in its opening brief do not support its claim that ETC "promoted, endorsed and catered to" Taylor during the 2008-09 period that ETC provided SDIRA custodial services to new Taylor investors. **(Point B** below) **(iii)** After ETC's secondary review of Taylor – done voluntarily and when other SDIRA custodians were not doing such reviews – ETC declined to take on new Taylor investments. But as it then lacked a basis to publicly accuse Taylor of fraud, ETC could not prevent its existing customers from extending their notes if they chose to do so, or thereafter prevent Taylor from using two different SDIRA custodians in accepting new investments from non-ETC customers. **(Point C** below)

A. Testimony by Taylor Investors

The Division says that approximately 80 ETC customers invested with Taylor. (OIP ¶30) Based on its pre-hearing disclosures, it appears that during the Division's years of investigation it spoke with all or most of these 80 individuals. Having the opportunity to subpoena to the hearing the investors it deemed most favorable to its case, the Division presented only six investors to testify, all of whom, as discussed in ETC's opening post-hearing brief and below, plainly did not invest with Taylor based on anything ETC did, let alone substantiate that ETC was a "cause" of Taylor's fraudulent conduct. This selective presentation warrants an inference that the other 74 individuals would have been even weaker witnesses for the Division's case.

(1) [redacted] Dorio. As discussed in ETC's opening brief with record cites, ETC did not "cause" Taylor to defraud Dorio, who apparently was his largest investor. (ETC Br. pp. 17-20) As Dorio's own testimony and the context of her investment reflects, ETC did not motivate her investment decision. When Dorio invested in January 2009, Taylor was a universally celebrated business leader, had been a speaker at the 2008 Democratic National Convention, and was presented as a big success story on numerous national television programs and in print media. His book had appeared twice on The Wall Street Journal's best seller list. (ETC Br. pp. 13-15) Neither ETC nor those closest to Taylor – including City Capital's auditors, outside accountant, outside attorneys, and Taylor's personal outside publicist – suspected any wrongdoing by Taylor.

Dorio first met Taylor at her church, which had a "substantial" place in her life and where she was "very active." The occasion was a Taylor presentation to 300-400 church volunteers, and it began with a video showing Taylor being interviewed on prominent television shows. (Dorio Tr. 830-34) Dorio testified that she invested with Taylor based on what she was told in multiple in-person meetings and biweekly phone calls with Taylor and his staff stretching over several months. (DX-36, Taylor Dep. 184-89; Dorio Tr. 798-99, 836-43)

In stark contrast, Dorio could recall a total of "two or three" phone calls with Batt at ETC. (Dorio Tr. 856) Dorio testified that Taylor's introduction of ETC in a phone call led her

to choose ETC as her SDIRA custodian, and not that ETC's presence or "role" somehow operated as a silent endorsement of Taylor. When the Division asked her the leading and focused question whether ETC's presence gave her "any comfort in deciding to invest with Mr. Taylor," she replied, but in the opposite direction – that Taylor's introduction of ETC gave her comfort to use ETC as her SDIRA custodian: "Sure. I mean, you know, we liked what Ephren said, we believed in Ephren, he worked with Robert Batt, Robert Batt, you know, did all the deals, you know, so I felt very comfortable working with Equity Trust. Plus Equity Trust is a large corporation." (Dorio Tr. 800-01)

Dorio has a bachelor's degree in business with accounting, finance and business law courses, and has worked for more than a decade in the accounting departments of two companies. (Dorio Tr. 826-28) The Division argues that Dorio's DOI said she wanted a "secured" investment with Taylor. But her testimony shows that she understood this to mean simply a company-backed promise to pay, which is what she got in the Taylor investment documentation that she accepted and signed. She understood that the "secured" nature of her Taylor investment – stated in the DOI as being secured by the "company" – meant simply that it was "backed up by a business." (Dorio Tr. 805-06) This meant that "[i]f someone didn't pay the note, then that would mean that the company is the collateral." (Dorio Tr. 880-81)

In addition to her business education and experience, by the time Dorio invested with Taylor, she already had experience with three SDIRA custodians other than ETC, so she understood the limited role played by SDIRA custodians. During the period when she served as the Houston chapter president of the American Cash Flow Association – which involved holding meetings on "buying notes" among other non-traditional investments, and which she testified turned out to be a scam – she heard about SDIRA custodian Pensco Trust Company in connection with making investments. Furthermore, the real estate investment trusts she had bought and continued to keep in her mother's AIG account before her investments with Taylor were held by SDIRA custodian Sterling Trust Company. Additional funds in the AIG account were held by yet another SDIRA custodian, SunAmerica Trust Company. (Dorio Tr. 843-47, 849-51; RX-232) Indeed, Dorio said she felt "comfortable with Equity Trust" because its "forms looked exactly the same" as the forms she was already using for her mother's SDIRA investment with Sterling Trust as custodian. (Dorio Tr. 848-49)

The Division's "causation" case with respect to Dorio focuses on the last week of a Taylor multi-person sales effort that had been going on for several months. By January 7, at the near culmination of Taylor's months-long "courting," Dorio had already directed AIG to liquidate a portion of the assets in her mother's AIG account to fund her investment with Taylor, and the sell orders in her mother's AIG account had already been placed. (DX-278, 279) The Division is mistaken in saying that the next day, January 8, Dorio's AIG broker "warned her" against her proposed investment with Taylor. In fact, the AIG adviser's January 8 letter to Dorio actually states that "I do believe in these types of investments," and while reminding her that he had previously sold her two real estate investment trusts, he just wanted her to understand the risks "as well as the benefits of what you may be getting into." (DX-830) For this reason, Batt –

who never actually saw the letter (Batt Tr. 474) – was misinformed in asking Dorio in a January 14 call, "[h]ow can this broker comment on real estate when he has never done it" (DX-14) because the AIG broker had admittedly already sold two substantial real estate investments to Dorio and believed "in these types of investments." (DX-830)

This solitary January 14 comment by Batt, which as noted above, was based on Batt's mistaken assumption about the contents of the AIG broker's letter to Dorio and was made a full week after Dorio had already placed her AIG sell order to fund her investment with Taylor, is the closest the Division can get to a supposed ETC recommendation of Taylor. It is clear that this comment not only was not a recommendation, but also that it had no bearing on Dorio's investment decision. Batt and Dorio both testified at the hearing, and neither said that ETC did anything to "sell" Taylor to Dorio. The furthest Dorio would go was to say that ETC did <u>not</u> say that it was <u>not</u> recommending Taylor. (Dorio Tr. 823-24) Contrary to the Batt and Dorio testimony, and contrary to the contemporaneous documents, the Division cites Taylor's jailhouse deposition testimony that Batt "was able to dismantle" the AIG broker, "get their confidence in the deal," and "got that sold." (DX-36, Taylor Dep. 115) In addition to faulty recollection and hearsay opinion testimony after almost seven years – January 2009 events recalled in October 2015 – Taylor was plainly motivated to "please the prosecutor." He admitted on cross-examination that his "ongoing cooperation effort" could still get him "cooperation credit" to possibly get his lengthy sentence reduced, and that he believed the lawyers from the SEC would have input into this process. (DX-36, Taylor Dep. 156)

A week after placing her January 7 AIG sell order, Dorio emailed Taylor's principal sales deputy Chris Lewis on January 14 and told him that "[w]e have the victory and nothing else will hinder or delay this coming to pass." In the email, she gave Lewis her AIG account number, username and password, and asked him if there was "anything else you need or want." (RX-232) She did this "because he [Chris Lewis] worked with Ephren and I was moving the funds from AIG eventually to Ephren, I knew that Chris would need this information." (Dorio Tr. 859) In the context of Dorio having just emailed Taylor's deputy that "nothing else will hinder or delay" the transfer to Taylor already in motion, Batt's email <u>later</u> that day (DX-14) telling Taylor that Batt would "close it," refers to completing the funds transfer into the SDIRA account, and not to convincing Dorio to invest with Taylor. Batt so testified at the hearing and stood for cross-examination. (Batt Tr. 479) Even Taylor confirmed in his deposition that "close it" meant it already "was a done deal" and that Batt would simply "get the money wired over." (DX-36, Taylor Dep. 116) Not that Batt would convince Dorio to invest with Taylor.

Immediately above her signature in bold type on each DOI form, Dorio agreed that "I, alone, am responsible for the selection, due diligence, management, review and retention of all investments in my account"; that "I agree that [ETC] is not a 'fiduciary' for my account"; and that "I hereby direct [ETC], in a passive capacity, to enact this transaction for my account." On the top of the same page, under the heading "IMPORTANT: Please Ensure That You Read The Following Disclosures Before You Sign and Date These Documents," the very first sentence said: "1. Equity Trust Company (Custodian) does not offer any investment advice, nor does it

endorse any investment, investment product or investment strategy...." (RX-151, image 6/121, DOI form, p. 4; RX-181, image 6/103, DOI form, p. 4; Dorio Tr. 866-68, 881-82)

(2) [redacted] Hill. As discussed in ETC's opening brief with record cites, ETC did not "cause" Taylor to defraud Hill. (ETC Br. pp. 16-17) Hall invested in June 2008, seven months earlier than Dorio, and at a time when Taylor's public image could not have been higher and when there was no evidence that Taylor was committing securities fraud or any other unlawful acts.

The events leading up to Hill's investment demonstrate the non-role played by ETC. Taylor spent a week at the Florida church where Hill was a deacon. Before his first meeting with Taylor in the church's "deacon room," the church's pastor had told Hill that Taylor was meeting with the pastor regarding the church's finances and that Taylor "was a young, successful millionaire and that he was a member of the church." (Hill Tr. 179, 181) In a later separate meeting with Taylor, Taylor personally told Hill that he "can get [me] retired quicker, because that was one of my dreams." Taylor told Hill that he was offering a 10% return on investments after which Hill, at Taylor's suggestion, then had a "quick call" with Batt at ETC. (Hill Tr. 170-71, 179, 184-85) Batt nor anyone was else from ETC was at the church. In a conversation that Hill testified lasted only one minute, Batt simply repeated that City Capital's notes had a 10% return. Beyond this, Hill recalls Batt saying only that Taylor had a "good" company. This one-minute phone call was the sole and only conversation Hill had with anybody at ETC. (Hill Tr. 172, 186-87, 191) Hill thought that ETC was endorsing Taylor and his company, but that "Equity Trust wasn't endorsing the investment." Hill acknowledged that he would not say he got "an okay" from ETC on whether to invest with Taylor. (Hill Tr. 156-57, 175)

Hill and his spouse, an IRS agent, determined to invest with Taylor. And when the note matured a year later and Hill was considering making an additional investment, Taylor paid for the flights, hotel and meals for Hill and his spouse to spend a weekend in Raleigh to see Taylor's offices, at which time they agreed to renew their original note and add more funds. (Hill Tr. 165-66, 192-93) Hill had no discussions or other communications with anyone from ETC before making this additional investment. (Hill Tr. 191)

Immediately above his signature in bold type on the DOI form, Hill agreed that "I, alone, am responsible for the selection, due diligence, management, review and retention of all investments in my account"; that "I agree that [ETC] is not a 'fiduciary' for my account"; and that "I hereby direct [ETC], in a passive capacity, to enact this transaction for my account." On the top of the same page, under the heading "IMPORTANT: Please Ensure That You Read The Following Disclosures Before You Sign and Date These Documents," the very first sentence said: "1. Equity Trust Company (Custodian) does not offer any investment advice, nor does it endorse any investment, investment product or investment strategy...." (RX-135, image 13/84, DOI form, p. 4; Hill Tr. 187-91)

(3) ██████ Sims. As discussed in ETC's opening brief with record cites, ETC did not "cause" Taylor to defraud Sims. (ETC Br. pp. 21-22) She too invested with Taylor at a time when Taylor enjoyed a positive public image. Sims invested based on seeing Taylor discuss socially conscious investing on a national Christian television network, after reading two of Taylor's books, and after researching Taylor online by conducting Google and Better Business Bureau searches. She even called City Capital's offices prior to her investment and spoke with a member of Taylor's team in her effort to learn more about Taylor's community investing program. All of this was done prior to any contact with ETC. (Sims Tr. 1398-1401, 1427-34) Her sole interactions with Batt at ETC consisted of two phone calls that simply had to do with setting up the SDIRA account. (Sims Tr. 1402-05) The Division did not even try to ask Sims whether Batt or anyone else from ETC endorsed Taylor or otherwise encouraged her to invest with him.

Sims had a BS in business management, with courses in accounting, finance and investments, and after starting in banking, she worked over 30 years as an analyst at Boeing. (Sims Tr. 1398, 1423-24, 1450-52) She understood that the "secured" nature of her Taylor investment – stated in the DOI as being secured by the "company" – meant simply that "if anything happened, you know, and for – [City Capital] would be responsible for, you know, paying the money back." (Sims Tr. 1445) So this obligation reflected in the DOI was identical to City Capital's undertaking in its promissory note. (Sims Tr. 1407-08, 1442-47)

Immediately above her signature in bold type on the DOI form, Sims agreed that "I, alone, am responsible for the selection, due diligence, management, review and retention of all investments in my account"; that "I agree that [ETC] is not a 'fiduciary' for my account"; and that "I hereby direct [ETC], in a passive capacity, to enact this transaction for my account." On the top of the same page, under the heading "IMPORTANT: Please Ensure That You Read The Following Disclosures Before You Sign and Date These Documents," the very first sentence said: "1. Equity Trust Company (Custodian) does not offer any investment advice, nor does it endorse any investment, investment product or investment strategy...." (RX-168, image 6/41, DOI form, p. 4; Sims Tr. 1445)

(4) Three New Birth Congregants. As discussed in ETC's opening brief with record cites, ETC did not "cause" Taylor to defraud the three members of the New Birth Church who were called as witnesses – ██████ Jones, ██████ Turner and ██████ Wells, or cause their investments to be made. (ETC Br. pp. 27-30) These longtime New Birth congregants invested with Taylor based on their respected Bishop's strong endorsement of Taylor and after hearing Taylor speak at one or more events during his week-long visit to the church and meeting with Taylor's sales representatives in one-on-one meetings. ETC was inconsequential in their decisions to invest.

██████ Jones: Jones has an MBA and has worked as a science teacher and small business owner. (Jones Tr. 122-27) He heard his Bishop introduce Taylor on Sunday as a "man of God" and spoke personally with Taylor while buying his autographed book. Later that same day, Jones decided to invest based on separate discussions with several Taylor sales

representatives at the church, all with Batt not present. (Jones Tr. 112-13, 136-39, 150-51) Having already decided to invest, Jones returned on Tuesday and spoke with Batt about how the SDIRA worked, not about investments with Taylor. (Jones Tr. 111-12, 145-47) Indeed, it appears that Jones thought that Taylor simply "was the matchmaker" introducing the company Jones actually invested in, Resilient Innovations. Jones did not understand Taylor to be "signing off on Resilient Innovations." (Jones Tr. 159) Jones did understand that "Equity Trust wasn't endorsing the investment." (Jones Tr. 156) Jones testified that he had never heard of ETC before attending Taylor's presentation at New Birth. (Jones Tr. 100)

[redacted] Turner: Turner has a BS in health administration, and her spouse was an elder at New Birth. (Turner Tr. 1346-47, 1375-77) They saw Taylor on the national Montel Williams television show, heard Taylor speak at New Birth's Sunday service, heard him speak again for hours at the Tuesday evening event, met with Taylor's sales representatives one-on-one at the church to discuss investing, and then had a personal meeting with Taylor a few weeks later at an Atlanta hotel. (Turner Tr. 1351, 1356-58, 1378-84, 1392-93) In stark contrast, Turner and her spouse saw Batt smile but not speak at the Tuesday event, spoke afterwards with Batt for only two or three minutes in an "informal" conversation, could not recall what Batt said about Taylor, and never spoke to Batt or anyone else from ETC again until after their loss. (Turner Tr. 1354, 1356, 1371-72) Like others, all the Division could get Turner to say was that ETC did not say that it did not endorse Taylor. (Turner Tr. 1356) Before the New Birth event, she had never heard of ETC. (Turner Tr. 1351) After a small investment through ETC, Turner and her spouse made the bulk of their investment with Taylor through a different SDIRA custodian in 2010, as Taylor instructed, as well as a separate cash investment not involving an SDIRA. (Turner Tr. 1365-67, 1385-90)

[redacted] Wells: Wells had been a New Birth member for over 20 years and considered Bishop Long as "a father figure." (Wells Tr. 45) She had studied applied behavioral sciences in college, worked 34 years for AT&T, and after further study became a licensed real estate broker. (Wells Tr. 81-82) Wells attended several of Taylor's presentations at New Birth and returned later in that week to meet one-on-one with one of Taylor's sales representative. (Wells Tr. 52-56, 63-64, 72-77) Her only contact with Batt was briefly listening to him talk about SDIRAs in the church lobby after Taylor's Tuesday evening presentation. He referred questions about Taylor to him and his staff. (Wells Tr. 70-72, 79-80) Like others, all the Division could get Wells to say was that ETC did not say that it did not endorse Taylor. (Wells Tr. 26) She had never before heard of ETC. (Wells Tr. 94-95)

Jones, Turner and Wells: Immediately above their signatures in bold type on their DOI forms, Jones, Turner and Wells each agreed that "I, alone, am responsible for the selection, due diligence, management, review and retention of all investments in my account"; that "I agree that [ETC] is not a 'fiduciary' for my account"; and that "I hereby direct [ETC], in a passive capacity, to enact this transaction for my account." On the top of the same page, under the heading "IMPORTANT: Please Ensure That You Read The Following Disclosures Before You Sign and Date These Documents," the very first sentence said: "1. Equity Trust Company

(Custodian) does not offer any investment advice, nor does it endorse any investment, investment product or investment strategy...." (RX-142, image 6/58, DOI form, p. 4 (Jones); DX-696, p. 160, DOI form, p. 4 (Turner); RX-183, image 7/36, DOI form, p. 4 (Wells))

(5) Assessment by Marketing Expert. The Division believes that the above-cited investor testimony supports its argument that ETC "caused" Taylor's securities fraud violations because ETC's mere presence and limited statements supposedly "endorsed or gave legitimacy to Taylor," "gave comfort" to investors, and thus "caused" them to invest. (Div. Br. pp. 88, 89, 93, 96, 104) A full and contextual review of the investor testimony at the hearing shows that, to the contrary, investors did not rely on ETC in making their decisions to invest with Taylor. ETC was at most in the background as an SDIRA custodial service provider that the investors had never heard of, and that they had extremely limited contact with during the period leading up to making their investment decisions. However, even if the Division had proved that prospective investors relied on anything ETC did or said – which the Division did not prove – such reliance would be irrelevant and certainly would not prove that ETC "caused" Taylor's securities fraud violations.

Nevertheless, to affirmatively counter the Division's "reliance" approach to showing "causation," ETC submitted the expert report of Professor Kurt Carlson, a Professor at Georgetown University's McDonough School of Business, who focuses his research and writing on marketing and consumer choice decisions. As he testified, in addition to teaching, "the bulk of what I do is do research on how people make decisions," and he runs an institute on how "consumers make decisions." (Carlson Tr. 1455-56) Based on an assumed statement of facts in his report that largely tracked the allegations of the OIP, and that specifically cross-referenced the relevant paragraphs of the OIP, Professor Carlson concluded "that ETC's presence in the decision process did not positively influence prospective investors' willingness to invest with Taylor." (RX-224, Carlson Expert Report, p. 14)

Professor Carlson explained that Taylor was a "strong brand" in the eyes of prospective investors, based on his national profile and media coverage, and that his brand was "explicitly bolstered" by introductions such as that given by Bishop Long at New Birth Church, as well as by "various dimensions of similarity" that Taylor had with his prospective investors. (*Id.*, pp. 14-15) For example, the Taylor presentation at New Birth began with video clips of his appearances on national television shows that presented him as a highly successful young millionaire and entrepreneur. (RX-35; Wells Tr. 57-58, 60-61) Professor Carlson also found it significant that prospective investors first became interested in Taylor and then "discovered the need for a third party custodian such as ETC relatively late in the process," because "information encountered late in a choice process rarely has a material influence on choice." (RX-224, Carlson Expert Report, pp. 14-16) Professor Carlson also opined that "investors taken in by a Ponzi scheme might believe a third party custodian was material to their decision even though it was not," essentially for the reason that the investors would try to rationalize how, consistent with their own self-image, they could have made such a poor investment decision. (*Id.*, pp. 14, 20)

B. ETC Did Not "Promote, Endorse and Cater to Taylor"

Beyond the testimony of these six customers, the Division's opening brief cites particular activities and events that it claims show that ETC "promoted, endorsed and catered to Taylor." For each, the record evidence shows the opposite. And the record evidence certainly does not show that any of these activities or ETC's role at these events "caused" Taylor's securities fraud.

(1) Customer Account Information. The Division says that Batt gave City Capital status updates containing "confidential customer information" about "amounts that had been transferred" to ETC, "the timing of transfers," and efforts to complete the transfers. (Div. Br. p. 48) The Division also says that these ETC customers "typically" had not yet signed DOI forms at the time of these status updates. While ETC believes that the record evidence shows the contrary, in any event, since these customers were referred by Taylor, there is no dispute that they were setting up SDIRA accounts for the express purpose of investing with Taylor. (Div. Br. p. 49) In this regard, the Division's witness Marsh testified that "if the investment sponsor was working together with the client on an investment," it was appropriate to "provide general information at times, that the transfer hasn't arrived yet or maybe a dollar amount or when it's going to clear." (Marsh Tr. 222-23) Likewise, ETC's privacy policy allowed communications like these to facilitate the customers' intended transactions. (ETC Br. pp. 12-13)

The Division notes that these emailed status updates did not reflect that City Capital had provided ETC with its customers' account PIN numbers. The Division, however, acknowledges Batt's unrebutted testimony that City Capital gave Batt the PIN numbers by phone before he sent the updates. (Div. Br. pp. 49, 169-70; Batt Tr. 310-12) Batt repeatedly told the Division's counsel at the hearing that City Capital gave him the PIN numbers, which were contained on the customers' account opening forms, and his supervisor Marsh, called by the Division, testified that access to such general information was appropriate for anyone having the PIN number and that sharing this information was permitted if it was done in connection with carrying out the customer's investment. (ETC Br. p. 12) While the Division appears to argue in its post-hearing brief that ETC's efficiency in processing retirement account roll-overs is somehow evidence of causing Taylor's fraud (Div. Br. pp. 49-50), there is no evidence that processing the opening or funding of a customer's SDIRA faster caused Taylor to commit a securities fraud on that customer.

(2) Visit to Raleigh. The Division also argues that Batt's trip to Capital City's Raleigh offices, his only trip to City Capital's offices, was a "cause" of Taylor's fraud. (Div. Br. 169) The Division's own brief cites the uncontroverted hearing testimony of Taylor and Batt's supervisor Keith Marsh that the purpose of the trip was to educate City Capital representatives about how SDIRAs work. The Division, however, morphs this testimony, including Marsh's description of this as "an education spend," into its own conclusion, without any supporting record citation, that the training was really about "how to promote Equity Trust's role as a self-directed IRA custodian in [Capital City's] sales pitches." As discussed in ETC's opening brief

with record cites, this conclusion is at complete odds with the evidence. (ETC Br. p. 21) However, even if one of the purposes of that trip was to increase ETC's business through SDIRA education, this is industry-standard marketing. While the Division also claims that Batt scheduled another City Capital training session prior to the New Birth event, it does not provide evidence that such a planned second session ever occurred. (Div. Br. pp. 53-54, 169) Batt and his supervisor both testified that these types of SDIRA training sessions were appropriate and common. Notably, this June 2009 visit to Raleigh was the only occasion that anyone from ETC ever visited an office of City Capital for any purpose and Taylor neither arranged nor was present for the educational training sessions. (Taylor Dep. Tr. 67, ETC Br. p. 21)

(3) New Birth Event. The Division says that Batt got ETC's approval to attend the New Birth Church event, and that in advance he sent 800 packets containing SDIRA account opening applications. The Division says that at the Tuesday evening session of the event, the only session Batt attended, Taylor directed Batt to stand up in the audience, which Batt did. The Division says that Taylor called Batt his "banker," said it was "something" that ETC sent Batt to attend the event, and also said that Batt was a "qualified, educated, and informed financial professional." The Division says that Batt admitted not being a banker or financial "planner," but did not correct Taylor's "banker" statement after the event. None of this does ETC dispute. The simple fact, remains, however, that none of this, whether viewed separately or in the aggregate, constitutes a "cause" of Taylor's securities fraud.

As discussed in ETC's opening brief with record cites, the Division overlooks a number of important facts, robbing all weight from any argument that Batt's appearance at New Birth was a "cause" of Taylor's securities fraud violations. (ETC Br. pp. 24-27) Of the many Taylor events that took place across the country over several years – including many dozens held at churches where Taylor was enthusiastically endorsed by church leaders– this New Birth event was the only event anyone from ETC ever attended. Indeed, Taylor testified that he didn't even know that Batt would be at New Birth (Taylor Depo. Tr. 72), and the record evidence is that the invitation was extended to Batt by someone on City Capital's staff immediately after she received a call from ETC's in-house legal counsel in connection with ETC's secondary review of City Capital. (DX-344, pp. 2, 3) And while Taylor spoke at five well-attended sessions at New Birth that week, Batt attended only one session during which Taylor referred to Batt for approximately 60 seconds over the course of his speech that went on for well over an hour. When Taylor referred to Batt during that speech as his "banker," Batt was in the audience with the several thousand other congregants and without any microphone. The record evidence is that Batt never spoke at that presentation and only had a single brief conversation exchanging pleasantries with Taylor in the lobby. (ETC Br. pp. 24-27) While the Division says that there were thousands in the audiences at multiple church sessions that week, with Batt at only one session, it identifies only a few New Birth attendees who ever actually invested with Taylor using SDIRAs. (Div. Br. pp. 54-58, 168) In short, the event was pretty much a fizzle for Taylor.

(4) Possible Landing Page. The Division says that ETC created a "landing page" for City Capital customers on ETC's own website, that the landing page went live in August 2009,

and that it had a welcome message and links to ETC's SDIRA opening application and DOI form. The Division quotes the Taylor jailhouse deposition for the proposition that Taylor thought the landing page was a "huge credibility booster," but does not offer more that Taylor's conclusion for this. (Div. Br. pp. 58-59, 169) The only digital evidence of such a page is an "html" version that Batt testified never actually went live. His contemporaneous emails show that the page was posted at a location where he could invite City Capital to take a look and give an opinion, but also that two months later Batt was still huddling with the ETC technical staff on what should be included in the landing page. More to the point, when we look at the "html" version of the landing page – which based on the record may or may not actually have gone live – we see that it was nothing more than (i) a generic welcome copied verbatim from other landing pages, (ii) a disclaimer including such cautions as the repeated statement that ETC did not provide investment advice or endorsements, and (iii) links to generic account opening forms and literature on using SDIRAs to invest in real estate. (ETC Br. pp. 22-24) Indeed, there is no record evidence that a single Taylor investor ever saw this alleged landing page or anything that looked like it.

C. ETC Acted Appropriately in Reviewing Its Customers' City Capital Investments

(1) December 2009 Hold on Accepting New Customers. The Division cites no evidence to dispute the fact that ETC was a pioneer among SDIRA custodians in implementing its "secondary review" process. This review process, which ETC began using in 2009 in order to manage reputational and financial risk, was triggered on a purely objective basis – when there were 20 or more ETC customers invested in a specific investment or investment program, or when there was at least $1.0 million invested in that investment or investment program. The Division does not dispute that ETC's review of Taylor in the Fall of 2009 was among the very first secondary reviews ETC ever performed under this new process – indeed at a time when the process itself was still early in its development.

The Division does not dispute that, at the time the City Capital secondary review began in the Fall of 2009, ETC had received no customer complaints concerning City Capital, Taylor, or any of their related entities, and that this review was based solely on the objective criteria set forth above. There likewise is no dispute that after conducting its review, ETC's December 23, 2009 determination to stop accepting new customers investing with City Capital was based solely on the factors described in ETC's contemporaneous memorandum memorializing the review such as missing investment documentation, City Capital's continuing losses, negative net worth and auditors' "going concern" and internal controls issues, and maturing notes that were being extended. (RX-50) ETC's database research revealed no reported legal violations or negative news, and showed a "very positive" reputation in the marketplace. (ETC Br. pp. 30-31)

As noted above and in our opening post-hearing brief (ETC Br. pp. 31-32), customers whose DOI forms indicated that their Taylor notes were "secured by company" understood this to mean simply that the company would be on the hook to repay the note – essentially putting the

company's full faith and credit on the line, and duplicating the payment promise the company made in its promissory note. (Sims Tr. 1407-08, 1442-47; Dorio Tr. 880-81) During the course of the City Capital secondary review, a member of ETC's internal audit staff decided that the "secured" notation on the DOI was inconsistent with the fact that the promissory notes – signed by the customer as lender – did not reference any separate security beyond the company's promise to pay. Following the review, ETC determined to follow its staffer's recommendation and decided to reclassify "secured by company" notes on its books as unsecured, as the notes themselves lacked separate security.

(2) Continuing SDIRA Custodial Services to Existing Customers. The last Taylor-related investment ETC processed was on December 21, 2009, and the "hold" decision was on December 23, 2009. But the Division criticizes ETC for continuing to provide SDIRA custodial services during 2010 to existing ETC customers who had already invested with Taylor, including those customers who extended the terms of their notes during 2010. The Division apparently contends that ETC should have accused Taylor of fraud, and told existing customers to try to recoup their investments, at some unspecified point in 2009 or 2010.

ETC had no basis to accuse Taylor of fraud in 2010, nor was its determination to put City Capital on "hold" based on any finding of fraud. (Dea Tr. 1583-86, 1589-90; Desich Tr. 984-87; Marsh Tr. 262-63) The Division cites an ETC document (DX-121) created 14 months after putting City Capital on "hold" to argue that ETC should have reviewed a questionable blog called "Ripoff Report," but the record shows that ETC instead used reliable sources like LexisNexis and the EDGAR database in conducting its secondary review. The Division's causation case against ETC should not turn on whether the Division can during a four-year investigation ferret out obscure online information. What does the Division suggest would constitute sufficient investigation to avoid causation liability? Does the Division, with the benefit of its 20/20 hindsight, take the position that ETC should have hired a private investigator? Should Taylor's personal tax returns have been demanded? The undisputed fact is that ETC designed this review process completely on its own without any regulations or rules to guide ETC in its design or implementation, and allowed ETC to make a reasoned and reasonable decision based on the reliable information it reviewed.

While ETC had no reliable information suggesting Taylor was involved in a fraudulent scheme, Taylor's lawyer Robert Bovarnick also was "very stern" in making sure that ETC would not disparage City Capital to existing investors, and "[t]hat there wouldn't be anything negative said about City Capital and its operations." (DX-36, Taylor Dep. 326-27) Bovarnick participated in the early January 2010 phone conversation in which ETC notified Taylor of its "hold" determination and over the ensuing months facilitated the transfer of uninvested funds of new-intake customers from ETC to a different SDIRA custodian. (RX-10) In so doing, Bovarnick testified that he did not think he was assisting a Ponzi scheme. (Bovarnick Tr. 1777-82)

At the time of the hold and afterwards, ETC plainly had no basis to accuse Taylor of fraud, either publicly or in private communications with existing ETC customers who were holding Taylor-related investments. Well after ETC's December 23, 2009 "hold" determination, Taylor continued to be held in high public regard, and respected independent players validated his reputation. Thus, in February 2010 – almost two months after the "hold" – Taylor was a featured speaker on a panel at Harvard University on "Young Millionaire CEOs and Emerging Leaders," designed to "inspire and motivate" Harvard students and "give voice to young successful business leaders for the next generation." (RX-37; Davis Tr. 1676-77) The advertisement for the event, sponsored by Harvard Law School's Charles Hamilton Houston Institute, profiled Taylor – as of February 2010 – as follows:

> Ephren Taylor ... is currently the CEO of ... City Capital Corporation, ... recognized by the Wall Street Journal as one of the Top 100 Socially Conscious Corporations in the United States. ... Mr. Taylor is the youngest African-American CEO of any publicly traded company in United States history. ... In addition, through his action on green energy and philanthropy, Taylor is leading a new wave of CEO's focusing on corporate social responsibility. He appears regularly on FOX News, CNBC, and has been featured on network shows such as ABC's 20/20, Big Idea with Donnie Deutsch and Montel Williams show. He also has regular appearances in print and radio media including PBS, Black Enterprise, and the Miami Herald. ... [RX-37]

As 2010 rolled along, there continued to be no supportable basis for ETC or others to accuse Taylor of fraud. Around March 2010 or possibly later, at least three months after the hold, Taylor's outside publicist of several years, Raoul Davis, had his new wife invest a portion of her own retirement funds with Taylor – using a different custodian, as ETC was no longer accepting new Taylor investors. (Davis Tr. 1673-74, 1699) (Davis Tr. 1688-92) On June 15, 2010, six months after the hold, Taylor's company City Capital filed its financial statements, audited by a PCAOB-registered public accounting firm, with its Form 10-K on EDGAR. (RX-1) In late June 2010, Attorney Robert Bovarnick wrote as City Capital's "outside general counsel" to approximately 100 of Taylor's investors to propose a settlement trust to "ensure your entire investment is returned," and Bovarnick testified that, in so doing, he again did not think City Capital was a Ponzi scheme. (Bovarnick Tr. 1782, 1790; RX-11)

III. ETC DID NOT "CAUSE" A POULSON VIOLATION

The Division has not carried its burden of proving that ETC "caused" a Poulson securities fraud violation because, as with the discussion of Taylor above: **(i)** There is no "causal nexus" between ETC's actions and Poulson's primary securities fraud. Even if ETC had provided exceptionally poor service as an SDIRA custodian, which it plainly did not, this would not make it a "cause" of Poulson's criminal securities fraud. **(ii)** With the alleged underlying violation being criminal, the *KPMG* standard requires a showing of at least scienter for "causing" liability,

but the Division has failed to show that ETC acted with scienter or even negligence with respect to Poulson's fraud. Indeed, Poulson testified at the hearing that "no one from Equity Trust knew that he was repaying investors with new money." (Poulson Tr. 555) **(iii)** While challenged by the financial crisis, Poulson testified that he did not become pessimistic about his business model until the end of 2010 or in 2011, so any supposed underlying Poulson violation would likely have developed only *after* ETC took on its last Poulson account in May 2011. (Poulson Tr. 552-54; DX-41, p.10) We discuss these points in detail in our opening brief. (ETC Br. pp. 45-60)

The Division focuses again on topics that are simply not relevant to a "causing" determination under Securities Act §8A – for example, supposed investor reliance on ETC's involvement, ETC's general marketing of its custodial services, and ETC's internal reviews of customer investments. And the Division has not even carried its burden of proving the allegations it makes concerning these irrelevant topics. As discussed below: **(i)** The Division relies heavily on two Poulson investors, but their hearing testimony and contemporaneous documents instead show ETC acting in the background as an SDIRA custodial service provider, not as a promoter. (**Point A** below) **(ii)** The particular activities that the Division cites in its opening brief do not support its claim that ETC "promoted, endorsed and catered to" Poulson during the period that ETC provided SDIRA custodial services to new Poulson investors. (**Point B** below) **(iii)** After ETC's secondary review of Poulson – done voluntarily and when other SDIRA custodians were not doing such reviews – ETC declined to take on new Poulson investments. But as it then lacked a basis to publicly accuse Poulson of fraud, ETC could not prevent its existing customers from extending their notes if they chose to do so. (**Point C** below)

A. Testimony by Poulson Investors

The OIP, filed by the Division following its multi-year investigation, states that 26 ETC customers invested with Poulson. (OIP ¶52). At the hearing, however, the Division claimed that there were 34 ETC customers who invested with Poulson. (DX-41) Whatever the exact number of investors is, as with Taylor's investors, the Division spoke with a large percentage of these individuals during its investigation. And again, having the opportunity to subpoena to the hearing the investors it deemed most favorable, the Division picked just two investors who plainly did not invest with Poulson based on anything ETC did, as discussed below. And again it is fair to infer that the other 24 (or 32) ETC customers who invested with Poulson would have been even weaker for the Division.

(1) [redacted] Gatto. As discussed in ETC's opening brief with record cites, ETC did not "cause" Poulson to defraud Gatto. (ETC Br. pp. 37-39) Gatto first met Poulson in 2005 or 2006 through the South Jersey Real Estate Investors Association ("SJREIA"), where Poulson served as president. Gatto was a licensed real estate broker with experience investing in South Jersey real estate. He also had a bachelor's degree in aerospace engineering and a master's degree in physics.

In 2008, after witnessing Poulson serve as SJREIA President for two years, Gatto entered into an agreement to lend money to Poulson as part of Poulson's standard real estate investment program – that is, to buy a house at or below the amount of the outstanding principal of the primary mortgage, make any needed repairs, rent to a tenant with an option to buy, and hopefully after a short period sell the house at a profit, thereby allowing Poulson to pay back the money he had borrowed with a profit margin for himself. Gatto understood that the existing first mortgage could well exceed the house's ultimate sale price (if any), reflecting little or no equity at the outset, and that it could be subject to a variety of other existing liens or mortgages, which Gatto did not bother to check. Gatto funded his 2008 loan to Poulson with funds from his regular savings account and not an SDIRA. Accordingly, Gatto had no contact whatsoever with ETC and thus ETC plainly did induce him to invest with Poulson.

After his initial loan to Poulson, Gatto decided to enter into three more real estate transactions with Poulson the following year, this time using funds from an SDIRA. After shopping around and considering three different SDIRA custodians for his new Poulson investments, Gatto eventually settled on ETC after having a conversation with one of ETC's employees, Irene Berlovan. His conversation with Berlovan did not convince him to invest with Poulson even though he says she made "glowing" statements about him. Gatto had already made that decision, initially in 2008 and now again in 2009. Instead, as he testified, his conversation with Berlovan merely convinced him to select ETC as his SDIRA custodian instead of the other two custodians he was actively considering. Indeed, after years of attending Poulson-led SJREIA meetings and having already invested with Poulson the year before, Gatto by then had had far more contacts with and knew Poulson far better than Berlovan or anyone else at ETC. Gatto attended Poulson's Runnemede, New Jersey seminar, discussed below, only after having entered into his 2008 and 2009 loans to Poulson and on a day when nobody from ETC was present. So again, nothing ETC said or did at that event induced Gatto to invest with Poulson.

Following the three loans for which he used ETC as his SDIRA custodian, Gatto decided to enter into two additional transactions with Poulson. Both of these transactions were funded out of Gatto's personal savings and did not involve ETC or an SDIRA. By then, Gatto had risen up into SJREIA leadership. Throughout the relevant period, Gatto received his ETC SDIRA quarterly account statements advising him that ETC still had not received from Gatto a signed copy of the promissory notes for his three 2009 SDIRA investments with Poulson.

(2) [redacted] Savary. Likewise, as discussed in ETC's opening brief with record cites, ETC did not "cause" Poulson to defraud Savary. (ETC Br. pp. 40-42) Savary met Poulson in 2008 through SJREIA and heard him speak fairly frequently. Later, Savary attended several Poulson-Russo real estate investment educational seminars. At one of these seminars in April 2009, Savary testified that he heard ETC do a "mini-presentation," but that he "wasn't paying attention" to the ETC presentation since he did not need SDIRA services at the time.

In November 2009, Savary loaned money to Poulson to fund Poulson's standard real estate investment business model for house flipping based on money borrowed from others – the

same model on which Gatto invested, as discussed above. This was Savary's first investment with Poulson and he used his regular savings and not an SDIRA. Savary had no contact whatsoever with ETC in connection with this transaction, and thus ETC plainly did induce him to invest with Poulson. And like Gatto, in making this first loan to Poulson, Savary understood that the existing first mortgage could well exceed the house's sale price, reflecting little or no equity at the outset, and that it could be subject to a variety of other existing liens or mortgages, which Savary did not bother to check prior to investing.

When Savary's first loan matured in May 2010, Poulson's pay-off check bounced. Savary responded by orally agreeing to extend the note without any written renewal or extension. Savary said he did this because he trusted Poulson based on their prior interactions. It was in this context that Savary made a separate additional loan to Poulson, also in May 2010, this time using an SDIRA. Poulson told Savary that his investment would be used by Poulson in the same manner as his first investment, as discussed above, and Savary again understood that if the existing first mortgage on the property exceeded the property's sales price, he would not get his money back. As with his first Poulson investment, Savary did not bother to conduct a title search that could have revealed additional mortgages and liens on the property.

On the funding of his SDIRA investment in May 2010, ETC sent Savary a letter reminding him of his responsibility to provide the promissory note and the mortgage. Savary, however, never provided that note or a mortgage to ETC. ETC followed this letter by sending Savary quarterly account statements alerting him that ETC did not have a signed promissory note which would be needed before Savary could record any mortgage or other lien. When this loan came due in November 2010, Savary agreed with Poulson to extend the term of the loan at a higher interest rate. Thereafter, ETC's quarterly account statements indicated that ETC had received a promissory note but that it still had not gotten any mortgage from Savary.

(3) Gatto and Savary. Immediately above their signatures in bold type on their DOI forms, Gatto and Savary each agreed that "I, alone, am responsible for the selection, due diligence, management, review and retention of all investments in my account"; that "I agree that [ETC] is not a 'fiduciary' for my account"; and that "I hereby direct [ETC], in a passive capacity, to enact this transaction for my account." On the top of the same page, under the heading "IMPORTANT: Please Ensure That You Read The Following Disclosures Before You Sign and Date These Documents," the very first sentence said: "1. Equity Trust Company (Custodian) does not offer any investment advice, nor does it endorse any investment, investment product or investment strategy...." (RX-200, image 6/98, DOI form, p. 4 (Gatto); RX-214, image 5/59, DOI form, p. 4 (Savary))

B. ETC Did Not "Promote, Endorse and Cater to Poulson"

Beyond the testimony of these two customers, the Division's opening brief relies on ETC's appearance as a vendor at a single seminar and non-existent event cross-sponsorship to show that ETC "promoted, endorsed and catered to Poulson." For each, the record evidence

shows the opposite. And the record evidence certainly does not show that ETC "caused" Poulson to commit securities fraud.

(1) Poulson's April 2010 Runnemede Seminar. The Division says that ETC promoted and endorsed Poulson by sending Irene Berlovan and Edwin Kelly to appear at an April 2010 Poulson-Russo educational seminar. It is not disputed that Poulson conducted many of these real estate educational seminars over several years and that the April 2010 event was the only event at which anyone from ETC appeared. The Division says that Poulson at this April 2010 program introduced Berlovan as a member of his "power team," and the Division quotes Berlovan's very brief remarks as saying "[i]t's a very, very neat concept to be able to use [] your IRA money just as you use your money today. To go ahead and build your future income" – *i.e.* speaking generally about SDIRA accounts, as did Kelly in his longer remarks. (Div. Br. pp. 75-76) As is clearly evidenced by the video of Berlovan's remarks at that event, there was no promotion or endorsement of Poulson or of making investments with him. (ETC Br. pp. 39-40)

In fact, the so-called "power team" was simply a list of approximately a dozen outside vendors who were displaying their products and services at the event – accountants, lawyers, title abstract service providers, a financial strategist, an insurance agent, etc. – with Poulson calling all of these vendors his "power team." Berlovan spent virtually all of her time during that event sitting at a table out in the lobby and passing out ETC's standard marketing brochure to any attendees who expressed an interest in SDIRAs. Few did, and Berlovan could not recall speaking to a single person. In any event, she testified that she did not talk to the attendees about Poulson. (Berlovan Tr. 1234-35)

Kelly attended as a representative of the Retirement Education Group, an affiliate of ETC that focused on SDIRA educational programming. Kelly, who was "extremely ill" that day, "probably briefly" met Poulson, and then simply delivered his stock speech educating whoever would listen about SDIRAs generally. (E. Kelly Tr. 610-12, 631-33, 635-36) Kelly gave an "educational" presentation on SDIRAs. (Poulson Tr. 587-90) As noted above, Savary, the only attendee the Division called as a witness, testified that he "wasn't paying attention" to the ETC presentation. (Savary Tr. 1107-12) Based on Kelly's years of experience at ETC and elsewhere, he confirmed that across the industry "it's a common practice to build your name brand and to promote your services" by speaking at such events, and there could be "five or six" SDIRA custodians at some events. Custodians will sometimes pay a fee to appear, and they sell books and CDs about SDIRAs, while generally agreeing to split their book and CD sales proceeds with the event sponsor. (E. Kelly Tr. 625-29)

(2) Supposed Cross-Sponsorship of Events. The Division says that ETC agreed to sponsor Poulson dinner events for $600, and that Poulson agreed to sponsor an ETC conference for $750. (Div. Br. pp. 76-79) However, the Division acknowledges that neither side paid the other for any such events and even cites internal ETC emails referencing the absence of these payments. (Div. Br. p. 80) And beyond the emails proposing such cross-sponsorship, the record evidence shows that it never happened. Berlovan, who was Poulson's designated contact person

at ETC, did not go to any Poulson dinners or other events beyond the single Poulson-Russo educational seminar discussed above and is not aware of other ETC personnel attending other Poulson events. There is no record evidence of Poulson ever attending any ETC events either. (ETC Br. p. 35)

C. ETC Acted Appropriately in Reviewing Its Customers' Loans to Poulson

In Fall 2009, ETC began doing "secondary reviews" based on number of customers or total amounts invested with a particular issuer, and in so doing was a pioneer among SDIRA custodians, as noted above. (Dea Tr. 1576-78) In June 2010, ETC began such a review of Poulson. (DX-256). ETC saw document deficiencies and put together a list of missing documents that it sent to Poulson on November 30, 2010. (DX-209) Since ETC's customers had failed to provide these documents despite being reminded to do so in their quarterly account statements, ETC contacted Poulson regarding these missing documents. In the course of these contacts, Poulson never disputed his obligation to repay his promissory notes, regardless of whether the customers had obtained his signature on the note and forwarded a copy to ETC for their files. (Poulson Tr. 560-61)

Poulson did not become pessimistic about his real estate investment business model until the end of 2010 or in 2011, and testified at the hearing that at no time did anyone at ETC know he was repaying investors with new money. (Poulson Tr. 552-55) On January 21, 2011, Poulson sent a portion of the requested documents to ETC, and promised to send the rest. (DX-225) Poulson admits he was stringing ETC along. (Poulson Tr. 568-70) On May 11, 2011, ETC accepted its last customer planning to invest with Poulson. (DX-41, p. 10)

On September 20, 2011 – four months after ETC took its last Poulson customer – ETC staff recommended that Poulson be placed on "hold" status. On November 17, 2011, ETC's Governance, Risk and Compliance Committee met and formally placed Poulson on "hold" status. (DX-256) On November 23, 2011, the U.S. Attorney's Office in Camden, New Jersey mailed ETC a letter saying it was enclosing a subpoena. The letter did not mention Poulson at all. (DX-248) The subpoena itself is not in evidence, however in checking the investigative record (SEC-ETC-P-000021), Division counsel will see that the subpoena like the letter failed to even mention Poulson.

Years later, in May 2014 the U.S. Attorney filed a criminal complaint against Poulson, and in June 2014 he was indicted. Poulson pled not guilty and proceeded to defend the case, but later changed his plea, and the court entered judgment against him only about five weeks ago, on January 22, 2016. (DX-862) As of this writing, the Commission has still not filed a civil enforcement case against Poulson.

IV. THE DIVISION HAS NOT PROVEN A BASIS FOR THE RELIEF IT SEEKS

On the record evidence presented at the hearing, there should be no liability finding against ETC. For the reasons stated above and in our opening brief, the Division has not carried its burden of proving a "causal nexus" between ETC's activities and the alleged securities law violations by Taylor and Poulson. Even if this Court were to determine that the Division has met its burden of proof with respect to Taylor and/or Poulson, the Division has not established that they committed these frauds during the time ETC provided custodial services to certain of their investors. Further, as discussed herein and in our opening brief, the Division has not proven that ETC acted with scienter in causing their criminal conduct, or even that ETC acted negligently. (ETC Br. pp. 55-60)

There has never been an SEC enforcement action against an SDIRA custodian. A finding that custodial activities of the sort found here "caused" a securities fraud violation would be unprecedented and would completely upend the low-fee self-directed custodial model that has existed for decades. Costs would skyrocket if SDIRA custodians were to learn that they now must provide the expansive due diligence, record-keeping and reporting services now demanded by the Division and its expert, Pittsburgh attorney William Ries. It is apparent that both the Division and Ries fail to recognize that the duties they seek to impose here would have serious adverse consequences on investors using their retirement funds to make investments of their own choosing.

The Commission and NASAA would, in turn, have to revise their alerts to tell investors that SDIRA custodians now do – indeed "must" – provide the services that their investor alerts previously said were not provided. Courts dealing with SDIRAs invested with Madoff and lesser Ponzi schemes would have to overrule past precedent on the limited duties of custodians. And custodians would no longer be able to rely on mutually-agreed upon provisions in their customer custodial contracts limiting their duties in exchange for lower custodial fees. Any such change to an industry should come by statute or rulemaking, and not by litigation and administrative decision.

However, even if there were to be a liability finding here – which there plainly should not be – the Division has not proven a basis for a cease-and-desist order, disgorgement of some portion of fees, or a penalty, as discussed below.

A. Cease-and-Desist Order

The Division has never before charged an SDIRA custodian under Securities Act §8A for being a cause of another's violation of the antifraud provisions in §§17(a)(2) and (3). The Division's allegations concerning a custodian's duties in this case are directly contrary to what the Commission has said in its investor alert quoted above. Even if the Division were able to

show that ETC "caused" Taylor and Poulson to violate the securities laws, this would be without question a novel and unprecedented case.

Under circumstances where the there is no formal Commission precedent or official interpretive guidance – and indeed where the only Commission pronouncement as to a party's duties is to the contrary – there should be no cease-and-desist order. Thus, in *WHX Corp. v. SEC*, 362 F.3d 854, 860 (D.C. Cir. 2004), the D.C. Circuit vacated a cease-and-desist order 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." Likewise in *Monetta Financial Services, Inc. v. SEC*, 390 F.3d 952, 957 (7th Cir. 2004), the court vacated a cease-and-desist order and civil penalty where "no rules expressly required disclosure."

And contrary to the Division's suggestion (Div. Br. p. 186), ETC's determination to defend this proceeding is not a factor to be considered in determining whether to impose a cease-and-desist order. In *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1229 (D.C. Cir. 1989), the D.C. Circuit said that defendants "are not to be punished because they vigorously contest the government's accusations. We think 'lack of remorse' is relevant only where defendants have previously violated court orders ... or otherwise indicate that they did not feel bound by the law...." *See also SEC v. Todd*, No. 03CV2230, 2007 WL 1574756, at *50 (S.D. Cal. May 30, 2007) ("argu[ing] that they did not in fact commit a fraud" is "a wholly appropriate position during the pendency of ... motions [for new trial or other relief]," and should not be grounds for a sanction), *aff'd in part and rev'd in part on other grounds*, 642 F.3d 1207 (9th Cir. 2011).

Finally, there should be no order mandating a compliance consultant under Securities Act §8A(a) (allowing orders "take steps to effect compliance"). Without citing any precedent, the Division asks that this provision be used to order ETC to retain a compliance consultant. (Div. Br. p. 188) This is unwarranted. In *Matter of Raymond James Financial Services, Inc.*, 2005 WL 2237628, I.D. Rel. 296 (Sept. 15, 2005), Chief ALJ Murray denied the Division's request for an order requiring respondent to retain a compliance consultant. "Intervention of the type the Division proposes is an extreme measure warranted when it appears that the broker-dealer will not, or cannot, take remedial action on its own initiative." *Id.* at *67 (emphasis added). An order for a compliance consultant was unwarranted there, even though respondent was an SEC-regulated broker-dealer, unlike ETC which is not subject to the SEC's regulatory oversight and whose rules would be the guidepost for any compliance consultant's report. And such an order would be particularly unwarranted where the record here shows that ETC was a pioneer among SDIRA custodians in implementing an investment review process which, in fact, led ETC to stop taking any new business referred by Taylor or by Poulson, all well before law enforcement raised any questions and at times when both Taylor and Poulson enjoyed very positive reputations and public profiles. There is thus no basis to require the "extreme measure" of hiring a compliance consultant in the present matter.

B. Disgorgement of Fees

(1) No Proof of Gross Disgorgement Amount. The hearing record closed on December 10, 2015. At that point the Division had not proven even a gross amount as disgorgement. During the hearing, the Division's witnesses did not address disgorgement at all. And finally, on the last day of the hearing, the Division's counsel made his only statement concerning disgorgement, telling the Court:

> ... I just wanted to inform Your Honor that pursuant to the Court's direction at the pre-hearing conference on July 27th, that the Division provide Respondent with its theory of disgorgement and civil penalty, that we did that in an email on November 11th to provide them with an opportunity to provide evidence of inability to pay, that we provided them with that calculation and that as we've seen in the hearing, there was no evidence on inability to pay. ...

(Tr. 1853-54) The November 11th email referred to by counsel (Attachment "A" hereto) states only that "the Division will seek disgorgement of approximately $180,000," representing "amounts that Equity Trust collected in connection with the Taylor and Poulson accounts, and amounts that City Capital sent to Equity Trust directly." Its pre-hearing brief (p. 23) likewise said only that it wanted "approximately $180,000" in disgorged fees. No specifics, no breakdown, no calculation.

Absent proof concerning disgorgement, ETC's post-hearing brief correctly noted (p. 60) that the Division had chosen not to prove the amount of proposed disgorgement during the hearing and that, after four years of pre-OIP discovery, it should not be allowed to plug the hole in its proof by asking for a post-proceeding "accounting." The Division is now trying a different approach. Its post-hearing brief attached a new exhibit that is not in evidence and had never before been shown to ETC's counsel. The new unadmitted exhibit purports to do calculations based on particular items of data selected from hundreds of pages of account transaction details and other materials, in order to formulate a summary exhibit to support the Division's disgorgement claim. (In a February 1, 2016 letter to the Court, the Division withdrew its post-hearing brief and provided a replacement that did not include the new unadmitted summary exhibit on disgorgement.)

As the new summary exhibit has not been admitted, it should not be considered. If it is offered now, we object as it comes weeks after the record closed. We additionally object because admitting the exhibit so late in the process would create substantial prejudice. To admit the exhibit now would require us to go to the hundreds of pages of underlying transaction records, search for the data items the Division may have used, and attempt to recreate its calculations. But even if we did, we would at this point be unable to require the Division to produce a foundation witness explaining the calculations for cross-examination, and we would be unable to submit contrary proof with the hearing now long ago concluded. Nor would

allowing the Division to backdoor its missing proof by relying simply on argument presented in its brief solve this problem.

(2) No Showing of the Portion of Fees Subject to Disgorgement. Totally absent from the hearing record and from the Division's post-hearing brief is any attempt to break down the amounts paid to ETC to show what portion should supposedly be disgorged. Instead, the Division takes the sledgehammer approach of claiming everything. What portion of the fees were for allegedly "causing" a securities violation, versus the portion for custodial services? What portion of the fees pertain to time periods when nobody suspected any irregularities for either Taylor or Poulson? What portion of the fees were refunded to customers? What portion of the fees were paid on customers' behalf by City Capital, and did this come from its own funds? The record is silent on these points, and weeks after the conclusion of the hearing it cannot be reopened to thus try to answer these questions by dissecting the particular line items on the Division's new unadmitted summary exhibit.

As we pointed out in our opening brief, proof of gross fees paid is not sufficient. To prove a disgorgement claim 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).

(3) No Showing That Fees Causally Related. As further pointed out in our opening brief, 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). Here the charge is that Taylor and Poulson obtained illegal proceeds from their respective securities law violations. Fees that ETC received for custodial services to its customers, even if those services were negligently performed as the Division contends, are not proceeds from the Taylor and Poulson securities law violations.

C. Civil Monetary Penalty

If there were to be a penalty, it should not be what the Division seeks. While charging this as a negligence case, the Division now seeks "maximum" Third Tier penalties by calling it instead a recklessness case. Indeed, the Division's opening brief (p. 187) goes beyond simple recklessness and accuses ETC of "a high degree of recklessness," "egregious conduct," and having "deliberately disregarded" the law. The Division has pled negligence and failed to prove

it; it has neither pled nor proven "high recklessness" or "deliberate disregard. For this reason it has no basis to claim anything above a First Tier penalty.

The Division compounds the baselessness of its request for a Third Tier sanction by also asking for multiple penalties. The Division's opening brief (p. 187) seeks 19 separate penalties for ETC's custodial services relating to Poulson notes, and 2 separate penalties for Taylor's custodial services relating to Taylor notes. And while the Division realizes that it cannot seek penalties for activity before July 22, 2010, the Dodd Frank effective date, most of the notes used for its penalty calculation were simply customer-directed renewals of their earlier notes, where the customer actually invested before July 22, 2010.

The Division's penalty calculation asks the Court to apply the penalty provision in Securities Act §8A in a manner that would deny due process. Section 8A(g)(2)(A), (B) and (C) allow a penalty for "each act or omission described in" Section 8A(g)(1), which in turn describes only a unitary act – being "a cause" of a violation – suggesting that in the normal course only a single course of action should form the basis for a computation. Instead, the Division here arbitrarily seizes on notes renewed after July 2010 as being separate bases for penalties, as in other cases it has seized on a variety of other supposedly separate actions. Essentially, the Division's approach is to arbitrarily pick a big number and then back into it with a fanciful calculation methodology. *See Rapoport v. SEC*, 682 F.3d 98, 108 (D.C. Cir. 2012) ("SEC must provide some meaningful explanation for imposing sanctions"); *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).

There should be no penalty here for the reasons stated above and in our opening brief, but if there were to be a penalty, 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).

CONCLUSION

The Division's case rests on an exhaustive list of specific duties invented by Pennsylvania banking lawyer William Ries as the overall standard of care imposed on a South Dakota-chartered trust company providing SDIRA custodial services. Ries, who has no SDIRA experience at all, has offered views that are flat-out inconsistent with the statements of the SEC, NASAA and federal courts regarding the duties of an SDIRA custodian, and custom, practice and the standard of reasonable care in the SDIRA industry. If the standard is to change, it should be by legislation or rulemaking, not by enforcement proceedings. In any event, such a change should only be made prospectively and after the industry is given the opportunity to change its operations and substantially increase fees to cover the resulting costs.

The Division acknowledges that, as the record demonstrates, ETC had no knowledge of Taylor's and Poulson's misconduct. The Division seeks to get around this reality by cobbling together a case focusing on such irrelevant topics as allegedly overzealous ETC marketing to prospective SDIRA customers, allegedly insufficient training of sales staff (training that the unrebutted proof shows took at least four weeks), the commission-based sales compensation that is standard in the SDIRA industry, and faster SDIRA processing than some competitors. Beyond this, the Division complains of ETC's appearances at a single Taylor event and at a single Poulson event, where its involvement was miniscule and clearly did not "cause" criminal frauds. The hearing testimony that the Division sponsored from Taylor and Poulson should be disregarded as Taylor was then seeking to use his testimony to support an application to reduce his sentence and as Poulson the day after his testimony asked the Division to write in support of leniency at his upcoming sentencing. The Division adds to this stew a few decade-plus-old regulatory orders against Mid-Ohio Securities Corporation (involving irrelevant AML, net capital and broker registration issues) and mischaracterizes Mid-Ohio's 2009 Ohio state consent order that expressly found no violations regarding the investment programs mentioned.

None of this proves the Division's case. For the reasons discussed above and in our opening brief, the Division has not carried its burden of proving that ETC, either negligently or with the required showing of scienter, "caused" Taylor and Poulson to commit criminal violations of the Securities Act. Even if the Division could establish liability on its theory that ETC negligently caused such criminal violations, it has not proven a basis for the remedies it presently seeks. This proceeding should be dismissed.

Dated: February 29, 2016

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CERTIFICATE OF SERVICE AND FILING

Pursuant to Rule 150(c)(2), I certify that on February 29, 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

ATTACHMENT A

Walsh, Brian

From: Dean, Andrew <DeanAn@SEC.GOV>
Sent: Wednesday, November 11, 2015 3:48 PM
To: Crimmins, Stephen J.; hgroedel@ulmer.com; Walsh, Brian
Cc: Stoelting, David; Fitzgerald, Luke M.
Subject: Matter of Equity Trust, File No. 3-16594

Steve, Howard, Brian – In the Pre-Hearing Conference on July 27, Judge Foelak requested "that the Division convey to the Respondent the amount of civil penalties and/or disgorgement that they might want lest the Respondent, in the worst case scenario, want to put on some evidence of inability to pay." Tr. 7:8-13. Accordingly, this is to advise you that the Division will seek disgorgement of approximately $180,000, plus prejudgment interest. This figure includes amounts that Equity Trust collected in connection with the Taylor and Poulson accounts, and amounts that City Capital sent to Equity Trust directly. As referenced in Part III of the OIP, the Division intends to request an accounting.

The Division also intends to seek the maximum penalties allowable in connection with approximately 21 causing violations that occurred within the applicable period (this includes investments in Poulson and Taylor notes). *See* Securities Act, § 8A(g). In our view, the evidence presented at the hearing will warrant civil penalties to satisfy the criteria for First Tier, Second Tier and Third Tier ($75,000; $375,000; and $725,000, respectively, for each act or omission).

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