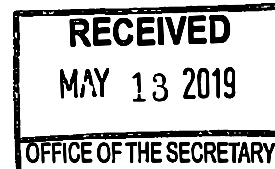
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-18061

In the Matter of

RETIREMENT SURETY LLC,
CRESCENDO FINANCIAL LLC,
THOMAS ROSE, DAVID
LEEMAN, AND DAVID
FEATHERSTONE,

Respondents.



DIVISION OF ENFORCEMENT'S REPLY MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION FOR SUMMARY DISPOSITION

DIVISION OF ENFORCEMENT
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Dated: May 10, 2019

The Division of Enforcement ("Division") respectfully submits this Reply Memorandum of Law in support of its motion for summary disposition against Respondents Thomas Rose ("Rose"), David Leeman ("Leeman"), and David Featherstone ("Featherstone") (collectively "Respondents").

ARGUMENT

Respondents argue in opposition to the Division's motion that (1) issues of material fact preclude summary disposition; (2) Respondents did not recklessly disregard regulatory requirements in acting as unregistered brokers; (3) Respondents' conduct did not create a substantial risk of losses to investors; and (4) Respondents are unable to pay monetary remedies due to their poor financial conditions. These arguments are unavailing.

First, there is no genuine issue of material fact as the only issues that remain are legal – the amount of proceeds received by Respondents is not in dispute, and the Division does not contest (for purposes of this motion) the financial information submitted by Respondents. *Second*, Respondents acted in reckless disregard of the regulatory requirements requiring a brokers' license to sell securities as they knew they needed a license to sell securities, and they knew that at least one attorney had opined that the Verto Notes were securities. *Third*, Respondents' actions created a substantial risk of losses to investors, as Respondents held themselves out as financial advisors and made claims regarding the safety and collateral of the Verto Notes, and thirty-two investors that Respondents solicited have lost money that they invested. *Finally*, Respondents' financial conditions do not warrant a reduction of disgorgement, as each has positive net monthly incomes or sufficient assets to pay full disgorgement and penalties.

I. Summary Disposition is Appropriate

Summary disposition is appropriate here as there are no material facts in dispute and only legal issues remain. *See, e.g., Middlebury Securities LLC et al.*, AP File Nos. 3-16227, 3-16229 (Mar. 1, 2017) (Initial Decision) (Judge Elliot). The case of *Middlebury*—cited by Respondents—is instructive here as the procedural posture was similar to the instant case: Respondents had agreed not to contest the factual findings in the Order, and the narrow issue before the court was monetary sanctions. In that case, the Court determined that where, as in the instant case, the amount of proceeds that was received by respondents was not in dispute, and the respondents submitted extensive financial information concerning their financial condition, only legal questions remained, and summary disposition was appropriate. *Id.* at 8. Specifically, the Court found the issues in that case – *i.e.*, whether disgorgement and civil penalties were in the public interest, and whether those respondents had an inability to pay – raised legal (not fact) issues appropriately resolved on summary disposition. *Id.*

II. Respondents Recklessly Disregarded Regulatory Requirements

Respondents argue that second or third-tier penalties are inappropriate, on the purported grounds that their conduct does not constitute reckless disregard of the regulatory requirement at issue – *i.e.*, that they act as licensed securities brokers. The undisputed facts establish, however, that Respondents' conduct was reckless. Respondents admit that they knew that selling securities without a license was a regulatory violation.[1] Furthermore, Respondents do not contest the fact that they had "concerns" that the Verto Notes were securities when they began selling them in November 2013 (and through at least June 2014). Order ¶ III.C.27. Indeed, as early as November 2013, Respondent Leeman indisputably knew that another broker's attorney

[1] *See* Opp. Memo at 13 (stating Respondents "investigated whether the Verto Notes were a security because they wanted to ensure regulatory compliance – that they could sell the Verto Notes without a securities license").

had opined that the Verto Notes *were* securities and that, for this very reason, that attorney had counseled his client (another potential Verto Notes-broker) *not* to sell the Verto Notes. That attorney's opinion plainly put Leeman on notice of the very real risk that his activities would violate the securities laws. *Id.* (Respondents' uncontestable settled Order states that "Respondent Leeman stated on November 15, 2013 that he received a call from another broker who 'called to let [Leeman] know that the attorney [the broker] asked to do his due diligence has recommended that he not participate' and '[t]he issue appears to be his opinion that our notes is a security.'"). Leeman's response to learning this opinion exhibits distain for regulatory requirements and pure greed: "Sure hope it's all OK because I wrote up $75,000 today!" Vakiener Decl. Exs. F & G.

Respondents argue that any such concerns that the Verto Notes were securities were alleviated by an August 2014 email from Verto attorney John Pauciulo, forwarded to Respondents by Verto's CEO. Opp. Mem. at 12 (citing App. 1426-28). That August 2014 email, however, cannot fairly be read to alleviate such concerns. To begin with, Verto's attorney, hardly a disinterested party, expressly stated in his email that "providing a formal legal opinion on this point would not be feasible." Moreover, and in any event, Respondents received that attorney's email nine months *after* they began selling the Verto Notes – all the while harboring concerns that to do so might be illegal – and, thus, cannot claim to have relied upon it.

Respondents also refer to "talking to their own counsel," and to their own research, which they assert, collectively, "provided them comfort that they could sell the Verto Notes without a securities license." Opp. Memo at 13. Respondents apparently refer here to an attorney named David Shelmire. Respondent Leeman, however, asserted privilege over his alleged conversations with Mr. Shelmire and, thus, cannot now assert reliance as a defense to this motion. Under these circumstances, a waiver of attorney-client privilege was required in

order to assert the defense. "The privilege which protects attorney-client communications may not be used both as a sword and a shield. *United States v. Bilzerian*, 926 F.2d 1285, 1292 (2d Cir. 1991). Furthermore, even if Respondents could assert reliance on counsel, they could not satisfy the elements of such a defense. To assert "reliance on counsel," Respondents must establish that they disclosed all relevant facts to Mr. Shelmire, and that they relied in good faith on his advice – neither of which they claim to have done. *SEC v. Tourre*, 950 F.Supp.2d 666, 683-85 (S.D.N.Y. 2013). Indeed, as Respondents have not waived privilege, they have not shared what facts, if any, they conveyed to Mr. Shelmire; what advice, if any, was provided by Mr. Shelmire; or that they reasonably relied on that advice. To the contrary, Leeman conceded in testimony that Mr. Shelmire was not retained to provide him any legal advice of the type he now claims. *Id.* Thus, by August 2014 – when Respondents received the Verto attorney email – the most Respondents can claim is that they had learned (from another broker's attorney) that the Verto notes *were* securities, and that selling them without a brokerage license would be illegal. These undisputed facts amply establish that Respondents acted in reckless disregard for their regulatory obligation not to broker securities sales without a license.

III. Respondents' Violations Created a Substantial Risk of Losses to Investors

Respondents further erroneously assert that third-tier penalties are inappropriate because their illegal actions allegedly did not create a substantial risk of loss to investors. Specifically, Respondents assert that (1) Verto note investors might not realize any losses because, as part of his settlement with the Commission in *SEC v. William R. Schantz III and Verto Capital Mgmt. LLC*, No. 17-cv-03115 (D.N.J.), Verto's CEO "has been ordered to repay investors, with interest through the fair fund that was established as part of his settlement", Opp. Memo at 11; and (2) Respondents were not aware of Verto's fraudulent conduct, *id.* at 10. These arguments miss the mark. Regardless of whether Respondents knew of Verto's fraud, Respondents' actions put

Verto investors at risk. As discussed in our opening brief, Memo at 20, Respondents solicited Verto note investors by advertising the notes as "low risk" and highlighted that the notes were "200% collateralized," Order ¶¶ III.C.18-19), and held themselves out as "financial advisors," *id.* ¶ III.C.25 – without satisfying the qualifications of registered securities brokers, *id.* at ¶ III.C.29. These regulatory obligations are specifically to hold brokers to a due diligence standard that protects investors from risk. Memo at 20-21. Respondents marketed themselves as having the financial qualifications and certifications to recommend the investment when, in fact, the Respondents were not licensed to sell securities and make investment recommendations. Thus, Respondents put potential investors at risk regardless of whether any underlying fraud existed.

Moreover, the investors solicited by Respondents were harmed. Respondents brokered sales of Verto Notes to thirty-two of the thirty-six investors who lost money on their Verto Notes. Memo at 22-23 (citing Vakiener Decl. ¶ 13). Defendants Schantz and Verto Capital Management LLC are more than $1.5 million delinquent on their obligations under the SEC's settled judgment. *Id.* This is the precise reason the Division will seek to add any monetary remedies recovered through this proceeding to the Fair Fund for distribution to these harmed investors, as the SEC did under its settlements with Respondents Randy Wallis and Ronald Wills. *Id.* (citing Vakiener Decl. Exs. K & L).

IV. <u>**The Court Should Award Disgorgement, Interest and Civil Penalties**</u>

Respondents further assert that monetary remedies are inappropriate because (1) they are unable to pay any, or only an unspecified portion of, the disgorgement, interest, and penalties the Division seeks; and (2) the requested relief is disproportionate to the amounts ordered in the related settled administrative proceeding against Respondents Wallis and Wills. Opp. Mem. at 6-9.

Based on Respondents' own affidavits of their financial condition, Respondents possess assets sufficient to warrant the monetary sanctions the Division seeks. Importantly, each Respondent reports substantial current monthly gross household income. Memo at 10-11, 15-16. In addition, Rose and Leeman assert that they each have current positive net monthly household income (net of their monthly expenses), Opp. Mem. at 7; and though Featherstone does not provide a monthly expense figure, his overall net worth (assets minus liabilities) is very substantial, Memo at 11 (citing Resp. App. at 1013). In any event, even if the Court were to find that "it will be difficult for [a Respondent] to pay sanctions," the Court should still be "reluctant to relieve [a respondent] entirely of his [disgorgement] obligation." *Middlebury Securities LLC et al.*, AP File Nos. 3-16227, 3-16229, at 13 (ALJ Mar. 1, 2017). Here, Respondents have not explained how they cannot reasonably pay disgorgement, given that they have positive net monthly income, particularly where the Court may order Respondents to make payments through an installment plan that would allow for them to pay any sanctions over time. *Middlebury*, at 14.

Respondents' comparisons to the relief the Division obtained in a settled proceeding against Wallis and Wills, Opp. Mem. at 8 n. 2, is also unavailing. The Commission and Respondents Wallis and Wills arrived at that monetary relief through a negotiated settlement, whereas Respondents here have chosen instead to litigate these issues.[2] Thus, Respondents' reliance is misplaced. *See Philip A. Lehman,* File No. 3-11972, Exchange Act Release No. 34-54660. 89 SEC 529, 2006 WL 3054584, at *9 (Oct. 27, 2006) (Commission Opinion) (rejecting Respondent's citation to other, settled disciplinary actions that were purportedly more

[2] Moreover, Wallis and Wills each paid disgorgement of under $25,000 because each of them received less than that amount in commissions. *See* Vakiener Decl. Ex. K (Wallis settled to pay disgorgement of $23,829 which was equivalent to the full commissions he earned), *id.* Ex. L (Wills settled to pay disgorgement of $10,000 where he earned only $13,240 in commissions).

egregious: "Settled sanctions reflect pragmatic considerations such as the avoidance of time-and-manpower-consuming adversarial litigation") (citing *Anthony A. Adonnino,* File No. 3-10916, Exchange Act Release No. 34-48618, 81 SEC 981, 999, 2003 WL 22321935 (Oct. 9, 2003) (Commission Opinion), *aff'd,* 111 Fed. Appx. 46 (2d Cir. 2004) (unpublished) (settled cases may result in lesser sanctions)); *Richard J. Puccio,* File No. 3-8438, Exchange Act Release No. 34-37849, 52 SEC 1041, 1045, 1996 WL 603681, at *4 (Oct. 22, 1996) (Commission Opinion). To the contrary, rewarding Respondents here with pre-litigation deals would provide a perverse incentive for all respondents to litigate and cause significant consumption of the Division's resources.

Respondents' argument that they should be credited for taxes they paid on their unlawful commissions likewise has been routinely rejected by the Commission. *See* Mem. at 15 n.8 (citing *Curtis A. Peterson,* AP File No. 3-17393, 2017 WL 2106270 at 4-5 (Apr. 19, 2017) (Initial Decision) (collecting cases)).

Finally, Respondents assert that the so-called "Forbearance Agreements" were not securities and that, therefore, Respondents should not be required to disgorge commissions they made on those instruments. The issue, however, is not whether the Forbearance Agreements are "securities" but, rather, whether Respondents' payments related to those agreements were "causally related" to Respondents' securities violations. *Dennis J. Malouf,* Securities Act Release No. 10115, 2016 WL 4035575, at *26 (July 27, 2016), *corrected,* Securities Act Release No. 10207, 2016 WL 4761084 (Sept. 13, 2016), pet. filed, No. 16-9546 (10th Cir. Sept. 8, 2016); *see Comeaux,* 2014 WL 4160054, at *3 (requiring "but-for causation"). The uncontested facts establish that the Respondents' additional commissions under the Forbearance Agreements were "causally related" to their securities violation and, thus, should be disgorged. *First,* Respondents themselves presented the "documents entitled

'Forbearance Agreements'" to investors "when Verto was unable to repay the investors' amounts under the original Verto Notes." *Id. Second,* the forbearance agreements extended the terms of the Verto Notes, Order ¶ III.C.22, and, thus, were derivative of the original unregistered sales. *Third*, Respondents already have conceded (and cannot contest here) that they were "brokering" the Forbearance Agreements. *Id.* ¶ 23. *Fourth*, Respondents earned 4% commissions on the amount outstanding for brokering the Forbearance Agreements. *Id.* ¶ 22. Accordingly, their additional commissions were derivative of the unregistered Verto Note sales and should properly be disgorged. Moreover, Respondents brazenly accepted new commission payments under the Forbearance Agreements after learning of the Division's investigation into their conduct related to the Verto Notes. Respondents thus continued earning profits derivative of the Verto Notes despite the clear and present risk that the Division viewed that conduct as violating the Federal securities laws, actions that further evince Respondents' recklessness.

CONCLUSION

For the foregoing reasons, as well as those set forth in the Division's memorandum filed on April 19, 2019, the Division respectfully requests that the relief requested in its motion for summary disposition be granted in its entirety.

Respectfully submitted,

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May 10, 2019

CERTIFICATE OF SERVICE

Pursuant to Rule 150 of the Commission's Rules of Practice, I hereby certify that on May 10, 2019, a true and correct copy of the foregoing was sent in the manner indicated below upon the following:

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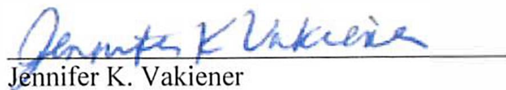

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