

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

Administrative Proceeding
File No. 3-20801

In the Matter of

DF GROWTH REIT II, LLC,
Respondent.

DIVISION OF ENFORCEMENT'S
REPLY TO DF GROWTH REIT II, LLC'S RESPONSE
TO THE DIVISION'S MOTION FOR SUMMARY DISPOSITION

June 28, 2022

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The Division of Enforcement (“Division”) submits this Reply in response to Respondent DF Growth REIT II’s (the “Respondent” or “REIT II”) Motion for an Order Vacating the Temporary Suspension Order served on June 21, 2022.

I. INTRODUCTION

On June 3, 2022, the Division moved, pursuant to Rule 250(a) of the Commission’s Rules of Practice, for summary disposition against REIT II in this proceeding and provided evidence that it not only violated multiple requirements of Regulation A, but also used offering and solicitation materials that contained numerous untrue or misleading statements of fact. In response, Respondent failed to offer any evidence or substantive argument to contradict these violations. As set forth below, the Division’s motion should be granted and a permanent order of suspension should be issued.

Instead of arguing the merits, which it knows it cannot do successfully, REIT II has engaged in procedural gamesmanship in order to escape any consequences, including the requested permanent suspension and the collateral consequences associated with such a suspension. Specifically, in an attempt to forestall the temporary suspension being made permanent, REIT II requested a hearing and then indicated to the Court that it would file a summary disposition motion. However, after the Court set a June 6th hearing date to determine whether the suspension should be made permanent, REIT II contacted the Division and asked to push out the hearing to a much later date. REIT II also failed to file a summary disposition motion or to even substantively oppose the Division’s summary disposition motion.

REIT II’s request that this Court vacate the temporary suspension order is without merit. Just because REIT II now purports to no longer be engaging in this particular offering does not extinguish the ability of the Court to impose a permanent suspension, nor does it mean that REIT

II did not violate the requirements of Regulation A. A culpable party's claim that it is no longer engaging in misconduct does not preclude a Court from finding it liable for its misconduct.

Moreover, what REIT II has neglected to tell the Court is that DiversyFund, Inc. ("DiversyFund"), REIT II's owner and manager, created Value Add Growth REIT III LLC ("REIT III"), an offering which it purports to be conducted through the Crowdfunding exemption. DiversyFund has also informed investors that it has transferred REIT II investor funds into REIT III. REIT II thus seeks dismissal of these proceedings for one reason: so that it can continue to raise funds without any adverse finding associated with a permanent suspension, which would trigger a bad actor disqualification that would make both REIT II and any successors ineligible to offer and sell securities in reliance not only on Regulation A, but also on Regulation D and Regulation Crowdfunding.

If this Court does not issue a permanent suspension on the basis of REIT II's multiple Regulation A violations, which REIT II does not dispute, REIT II and any successors will be free to rely on Regulation A, Regulation D, and Regulation CF to offer more securities without satisfying the information requirements of registered offerings, obtain more money from unsuspecting investors who will not be on notice of REIT II's prior fraudulent conduct, and not be held accountable for REIT II's violations of the securities laws—all at the expense of investors. This Court should therefore issue an order permanently suspending REIT II under Rule 258 of Regulation A.

II. THE COURT SHOULD FIND THAT THE DIVISION'S EVIDENCE THAT REIT II VIOLATED REGULATION A IS NOT IN DISPUTE

As stated in the Division's motion for summary disposition, the material facts underlying REIT II's violations are not in dispute. REIT II failed to comply with the terms, conditions and requirements of Regulation A by (1) engaging in an improper delayed offering, in violation of

Rule 251(d) and (2) raising its maximum offering amount from \$50 million to \$75 million through the filing of an offering circular supplement rather than through a new offering statement or amendment, in violation of Rule 253(b). REIT II's offering statements and solicitation materials also contained untrue or misleading statements of material facts relating to (1) the separation of REIT II from REIT I, (2) the minimum cash amount needed for its business and the significant risk of loss to REIT II investors if REIT II was unable to raise sufficient capital in its Regulation A offering, and (3) the fees that its investors would be charged. Some of these misrepresentations were ongoing until REIT II's temporary suspension of its Regulation A offering earlier this year, resulting in multiple investors seeking refunds from DiversyFund to no avail.

Under Rule 250(b), a hearing officer may grant the motion for summary disposition if there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law. 17 C.F.R. § 201.250(b). This case presents no questions of material fact, and the Division is entitled to summary disposition as a matter of law.

REIT II does not dispute these material facts. On May 26, 2022, the Court adopted the parties' proposed case schedule which set REIT II's due date for filing an opposition to the Division's motion for summary disposition on June 20, 2022.¹ REIT II elected not to file a substantive response disputing the facts set forth in the Division's motion and instead notified the Court that it had terminated its current Regulation A offering. The Division's motion must therefore be granted, and the Court should enter an order finding that there is no genuine issue of

¹ As June 20, 2022, was Juneteenth, a federal holiday, the deadline automatically rolled over to the next business day, June 21, 2022.

material fact.

III. THE COURT SHOULD NOT CREDIT REIT II'S GAMESMANSHIP

A. REIT II Misled the Court and the Division

When the Commission issued a temporary suspension pursuant to Rule 258 of REIT II's ability to offer securities in reliance on Regulation A, Respondent requested "a hearing to be held as soon as possible." *See* Respondent Request for Hearing Regarding the Commission's Order Temporarily Suspending DF Growth REIT II, LLC's Exemption. On April 1, 2022, Judge Patil issued an order scheduling the hearing for June 6, 2022. *See* Order Scheduling Hearing and Directing Prehearing Conference. On April 11, 2022, the parties filed a prehearing conference statement wherein REIT II represented to the Court that it intended to file a motion for summary disposition pursuant to Rule 250(b). *See* Parties' Joint Prehearing Conference Statement.

REIT II has since been back-tracking on any urgency for a hearing, informing the Division that it intended to file a motion to continue the hearing, which it filed on May 13, 2022. On June 3, 2022, REIT II did not file a motion for summary disposition, despite its prior representation to the Court. On June 20, 2022, REIT II did not file an opposition to the Division's motion for summary disposition. Instead, REIT II terminated its own offering on "the date we decided to end it," and requested that the Court dismiss the hearing that Respondent originally argued was to be "held as soon as possible." *See* Respondent's Response to the Division's Motion for Summary Disposition at 6.

This procedural posturing was deliberate on REIT II's part. REIT II knew that if it had not requested a hearing, the Commission would have entered a permanent suspension based on the operation of the rules. *See* 17 C.F.R. § 230.258(c) (stating that "[i]f no hearing is requested and none ordered by the Commission, a [temporary suspension] shall become permanent on the

30th calendar day after its entry and shall remain in effect unless or until it is modified or vacated by the Commission”). Put simply, Respondent attempted to hold the permanent suspension hostage and to buy itself time to create REIT III by misleading the Court on the need for an immediate hearing and its intent to litigate this case.

REIT II’s strategic efforts to forestall a permanent suspension under Regulation A by intentionally requesting a Rule 258 hearing, purposefully not filing a summary disposition motion or an opposition to the Division’s summary disposition motion, and then discontinuing its REIT II offering with no advance notice should not be rewarded. REIT II must be held accountable for its actions.

B. DiversyFund Created REIT III to Circumvent These Proceedings

As discussed in the Division’s motion for summary disposition, REIT II sought to utilize Regulation A’s privileges of offering its securities to the public without having to file a registration statement. However, it violated *multiple* of the requirements that were put in place for investor protection. Not only did it violate Regulation A’s requirements, but it also used offering and solicitation materials that contained numerous untrue or misleading statements of facts that investors deemed so material that they sought to withdraw their investments when they learned of the misstatements. *See* Division’s Motion at 13.

DiversyFund also transferred investor funds from REIT I to REIT II without the investors’ knowledge or consent. *Id.* at 7. In addition, DiversyFund posted to investor accounts Advisory Services Agreements which authorized DiversyFund to act as their investment advisers and enabled DiversyFund to transfer their investments between REIT I and REIT II without their knowledge. *See* Division Motion at 21. These Advisory Services Agreements fraudulently affixed the investors’ electronic signatures without their consent. *Id.*

There is now ongoing evidence that DiversyFund is engaging in these same illicit practices, but now with REIT III. On May 25, 2022, DiversyFund created a new offering for REIT III. Declaration of Stephen Kam (“Kam Decl.”). Ex. 1. This fund purported to be conducted through the Crowdfunding exception. *Id.* DiversyFund then informed its investors that “REIT 2 has [] closed and those funds have moved to REIT 3.” *Id.* Ex. 2.

A permanent suspension would help prevent further DiversyFund fraudulent practices in at least two ways. First, a permanent suspension of REIT II’s Regulation A exemption would inform the public of REIT II’s improper conduct and put investors on notice who continue to be brazenly solicited by those who control REIT II. Second, a permanent suspension would designate REIT II as a bad actor, the result being that for five years it (including any of its successors) would be ineligible to rely on not only the Regulation A exemption but also the Regulation D and Regulation Crowdfunding exemptions when offering securities.²

IV. THIS COURT SHOULD DENY RESPONDENT’S MOTION TO VACATE THE TEMPORARY SUSPENSION ORDER

A. REIT II’s Characterization of the Temporary Suspension is Inaccurate

REIT II suggests that because it has strategically discontinued its Regulation A offering, “this Court can offer no meaningful relief” and “has no alternative but to dismiss this administrative proceeding.” Respondent Response at 5, 9. REIT II’s argument implies that

² Under Rule 262(a) of Regulation A, Rule 506(d)(1) of Regulation D, and Rule 503(a) of Regulation Crowdfunding, each such exemption is not available for a sale of securities if the issuer or any predecessor of the issuer (or certain other covered persons) is a “bad actor” subject to one of the disqualifying events enumerated in the rules. An order suspending the Regulation A exemption with respect to REIT II would be such a disqualifying event under each of the Regulation A, Regulation D, and Regulation Crowdfunding bad actor provisions and would make such exemptions unavailable in any offering in which REIT II is the issuer or is a predecessor of the issuer.

For purposes of the Securities Act generally, the term *predecessor* means a person the major portion of the business and assets of which another person acquired in a single succession, or in a series of related successions in each of which the acquiring person acquired the major portion of the business and assets of the acquired person. *See* Securities Act Rule 405.

because it is no longer conducting its offering, the Court cannot issue a finding that REIT II did not violate Regulation A.

This obvious attempt to confuse the Court is wrong for three reasons. First, the rules clearly permit imposition of a permanent suspension notwithstanding the termination of the offering. *See* Rule 258(d) (stating “[t]he Commission may, *at any time* after notice and opportunity for a hearing, enter an order permanently suspending the exemption for any reason upon which it could have entered a temporary suspension order”) (emphasis added). Second, if this Court were to dismiss these proceedings against REIT II without issuing an order making the suspension permanent because DiversyFund voluntarily terminated this particular Regulation A offering, then REIT II would be free to commence another offering pursuant to Regulation A. Third, simply because a wrongdoer represents that it is no longer engaging in misconduct does not somehow preclude a Court from finding the wrongdoer liable for its actions.

B. REIT II’s Attempts at Drawing an Analogy to SEC Form 15 is Misleading

REIT II also hopes to convince this Court that the termination of its Regulation A offering is analogous to an issuer filing a Form 15 to voluntarily terminate the registration of a class of securities registered under the Exchange Act subsequent to the initiation of an Exchange Act Section 12(j) proceeding. Specifically, REIT II argues that where issuers voluntarily deregister their securities, no remedy is available and the Commission simply dismisses the Section 12(j) proceeding. Again, the Court should not be led astray by the Respondent’s misdirection.

First, the purpose of a Section 12(j) proceeding is to terminate the registration of a class of securities registered under Section 12 of the Exchange Act. By voluntarily filing a Form 15 and satisfying the criteria to terminate the registration, the registrant is bringing about the very

objective sought in the Section 12(j) proceedings – namely, the revocation or termination of the registration of the class of securities registered under the Exchange Act. Here, REIT II is not taking steps to bring about the objective sought in this hearing, which is a permanent suspension of REIT II from future use of Regulation A to raise capital. To the contrary, it is seeking the opposite – specifically, to avoid entirely the permanent suspension sought. REIT II’s Form 15 analogy could therefore not be more inapposite.

Second, in Respondent’s relied-upon cases, the Commission specifically held that filing a Form 15 does not remedy an issuer’s past violations or assure compliance with Exchange Act Section 13(a) in the event of re-registration. *See, e.g., Aqua Soc’y, Inc.*, Initial Decision Release No. 439 (Nov. 3, 2011) (finding that “the Form 15 does not remedy [the issuer’s] past violations or assure compliance with Section 13(a) in the event of re-registration”). In addition, despite REIT II’s assertion that the Commission has been inclined to dismiss the Section 12(j) proceeding where the issuer files a Form 15 during the pendency of the proceeding, in fact the Commission has been inclined to issue a revocation of the issuer’s registration where there existed the potential for continued harm to investors. *See, e.g., Earth Dragon Res., Inc.*, Initial Decision Release No. 786 (May 5, 2015) (“I accept the Division’s position, unchallenged in this proceeding, that revocation should occur despite Earth Dragon’s filing of a Form 15 on April 30, 2015, because voluntary termination of its registration would allow for continued quoting and trading of its securities by broker-dealers, and by failing to Answer or participate in this proceeding, Earth Dragon forfeited the opportunity to explain why unrestricted trading of its securities should continue despite its continued failure to provide public information about the company.”); *Validian Corp*, Initial Decision Release No. 94949 (May 19, 2022). In actuality, on the rare occasion where the Commission did issue a dismissal of Section 12(j) proceedings, it

was generally upon the Division's motion to dismiss, not the Respondent's motion. *See Largo Vista Grp., Ltd.*, Initial Decision Release No. 486, (May 3, 2013); *World Associates, Inc.*, Initial Decision Release No. 59034 (Dec. 1, 2008).

Here, as discussed above, failure to impose a permanent suspension creates a significant risk of harm to investors, as not only will REIT II be free to continue to utilize the Regulation A exemption to offer securities to investors, but it and its successors also will be able to use the Regulation D and Regulation Crowdfunding exemptions due to its avoidance of a bad actor disqualification. REIT II has provided no assurances that it will not attempt to make another offering in the future. To the contrary, DiversyFund has already begun transferring the funds of REIT II investors into REIT III. There thus exists no protection for investors from REIT II or its successors without a permanent suspension.

V. CONCLUSION

REIT II made no attempt to oppose the Division's motion for summary disposition pursuant to Rule 250(a), confirming that there was no issue of material fact that REIT II violated the requirements of Regulation A by failing to commence its offering within two days, by improperly increasing its offering amount without filing an amendment, and for having untrue statements or omissions of material fact in its offering documents or solicitation materials.

After its temporary suspension, REIT II pushed for an expedited hearing, gave the impression to the Court and to the Division that it sought to litigate, and then terminated its offering in an effort to escape both the sought after permanent suspension and the collateral consequences that would flow from a permanent suspension, thereby freeing itself and any successor to continue to raise funds from unsuspecting investors in reliance on exemptions it otherwise could not utilize. DiversyFund also created REIT III and transferred investor funds

from REIT II into this new fund.

This gamesmanship should not be enabled by the Court. The requirements of Regulation A were put in place for the protection of investors, and a violation of these requirements – particularly in this matter where REIT II also used materially false and misleading offering and solicitation materials – should necessarily result in the suspension of REIT II’s exemption.

For the foregoing reasons, the Division respectfully requests that the Court grant its Motion for Summary Disposition and permanently suspend REIT II from its continued use of Regulation A.

Dated: June 28, 2022

Respectfully submitted,
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