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8
9 **UNITED STATES DISTRICT COURT**
10 **CENTRAL DISTRICT OF CALIFORNIA**

11
12 **SECURITIES AND EXCHANGE**
13 **COMMISSION,**

14 **Plaintiff,**

15 **v.**

16 **JAMES ARTHUR MCDONALD, JR.**
17 **and HERCULES INVESTMENTS,**
18 **LLC,**

19 **Defendants.**

Case No. 2:22-cv-6799

COMPLAINT

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1 Plaintiff Securities and Exchange Commission (“SEC”) alleges:

2 **JURISDICTION AND VENUE**

3 1. The Court has jurisdiction over this action pursuant to Sections 20(b),
4 20(d)(1), and 22(a) of the Securities Act of 1933 (“Securities Act”), 15 U.S.C.
5 §§ 77t(b), 77t(d)(1) & 77v(a), Sections 21(d)(1), 21(d)(3)(A), 21(e), and 27(a) of the
6 Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. §§ 78u(d)(1),
7 78u(d)(3)(A), 78u(e) & 78aa(a), and Sections 209(d), 209(e)(1), 214 of the
8 Investment Advisers Act of 1940 (“Advisers Act”), 15 U.S.C. §§ 80b-9(d),
9 80b-9(e)(1) & 80b-14.

10 2. Defendants have, directly or indirectly, made use of the means or
11 instrumentalities of interstate commerce, of the mails, or of the facilities of a national
12 securities exchange in connection with the transactions, acts, practices and courses of
13 business alleged in this complaint.

14 3. Venue is proper in this district pursuant to Section 22(a) of the Securities
15 Act, 15 U.S.C. § 77v(a), Section 27(a) of the Exchange Act, 15 U.S.C. § 78aa(a), and
16 Section 214 of the Advisers Act, 15 U.S.C. § 80b-14, because certain of the
17 transactions, acts, practices and courses of conduct constituting violations of the
18 federal securities laws occurred within this district. In addition, venue is proper in
19 this district because Defendant Hercules Investments LLC (“Hercules”) has its
20 principal place of business in this district.

21 **SUMMARY**

22 4. This securities enforcement action involves two related fraudulent schemes
23 committed by Defendant James Arthur McDonald, Jr. (“McDonald”). All told,
24 McDonald fraudulently raised approximately \$5.1 million from about 23 investors
25 and clients, misappropriating more than \$1.5 million in investor money to fund his
26 lavish lifestyle and making at least \$1.4 million in Ponzi-like payments to investors.

27 5. First, between May 2019 and October 2021, McDonald, through his
28 control of Index Strategy Advisors, Inc. (“ISA”)—an unregistered investment

1 adviser—solicited over \$3.6 million from approximately 20 investors for ISA’s index
2 hedge fund, the ISA Fund.

3 6. McDonald told investors that the ISA Fund profitably traded securities,
4 but McDonald used less than half that amount for trading purposes, with long
5 stretches of time where he did not trade at all. McDonald sent ISA Fund investors
6 false account statements showing positive returns from trading and cash held at the
7 end of each month. In addition, McDonald commingled investor funds with funds
8 from his personal bank account, which had itself had been commingled with ISA
9 funds and those of an SEC-registered investment adviser McDonald also controlled,
10 Hercules. Using the commingled funds, McDonald made Ponzi-like payments to ISA
11 Fund investors and payments to clients of Hercules. McDonald also used \$1 million
12 of ISA Fund investor monies to fund his extravagant lifestyle, including purchasing
13 luxury vehicles, paying rent on his luxury home, and hundreds of thousands of dollars
14 on personal credit card charges, as well as to pay expenses associated with operating
15 Hercules.

16 7. Second, between February and October 2021, McDonald offered and
17 sold equity investments in Hercules itself, raising \$1.5 million from two types of
18 investors: one non-client group and two existing individual Hercules clients.
19 McDonald falsely represented to the non-client investor group that its funds would be
20 used to expand Hercules’s business, but he lied about the firm’s financial condition
21 and failed to disclose that he had promised Hercules clients that the firm would repay
22 earlier losses they had incurred as a result of bad trades McDonald had made in the
23 fall of 2020. McDonald also lied to the Hercules client investors telling them that
24 their funds would be spent on Hercules business operations or be used to engage in
25 securities trading. In fact, McDonald commingled their funds with his personal
26 assets, and used the money to make payments to clients and investors and pay
27 personal expenses, including purchasing a Porsche. In furtherance of his scheme,
28 McDonald also induced existing Hercules clients to make, on Hercules’s behalf,

1 payments of nearly \$1.1 million directly to other clients as partial repayment for their
2 trading losses in exchange for an equity stake in Hercules.

3 8. Through their conduct, and as further detailed below, Defendants
4 violated the antifraud provisions of Section 17(a) of the Securities Act, Section 10(b)
5 of the Exchange Act and Rule 10b-5 thereunder, and Section 206 of the Advisers Act
6 and Rule 206(4)-8 thereunder.

7 9. The SEC seeks findings that Defendants committed these violations;
8 permanent injunctions against each Defendant's future violations of the securities
9 laws; disgorgement with prejudgment interest from Defendants; and civil monetary
10 penalties against Defendants.

11 DEFENDANTS

12 10. **McDonald** was a resident of Arcadia, California at the time of the
13 conduct at issue here. He was the sole owner and control person of ISA and served as
14 the investment adviser to ISA's index option hedge fund, the ISA Fund. He was the
15 sole owner and control person of Hercules, and the portfolio manager of the Hercules
16 Fund. He was a registered with the SEC as an investment adviser representative with
17 Edward Jones from October 2001 to February 2002, with Compass Brokerage, Inc.
18 from December 2003 to April 2006, and with Kershner Trading Group, LLC in
19 October 2008. Until December 31, 2021, McDonald was an investment adviser
20 representative of Hercules.

21 11. **Hercules** is a California limited liability company that was based in Los
22 Angeles, California, incorporated on June 8, 2019. McDonald was its managing
23 member, CEO, chief investment officer, chief compliance officer, and majority
24 owner. Hercules served as the investment adviser to the Hercules Fund. Hercules
25 was registered as an investment adviser in California that was terminated effective
26 April 11, 2021. Hercules's registration as an SEC-registered investment adviser
27 became effective December 1, 2020. Hercules is currently registered with the SEC as
28 an investment adviser.

1 **RELATED ENTITIES**

2 12. **ISA** was a Texas corporation, based in Richmond, Texas, and Los
3 Angeles, California, incorporated on March 8, 2010. Its right to transact business in
4 Texas was forfeited on September 22, 2017 and it ceased as a legal entity when its
5 corporate charter was forfeited by Texas state authorities on January 26, 2018.
6 Between 2010 and 2019, ISA was registered as an investment adviser in Arizona,
7 California, Florida, Georgia, Ohio, Texas, and Virginia. ISA filed a Form ADV-W
8 effective May 1, 2019, which was a full withdrawal. ISA operated the ISA Fund, a
9 pooled investment vehicle within the meaning of Rule 206(4)-8(b), 17 C.F.R.
10 275.206(4)-8(b). The ISA Fund was not incorporated as an entity. Neither ISA nor
11 the ISA Fund were registered with the SEC in any capacity.

12 13. The **Hercules Fund** (ticker: NFLHX) was a mutual fund and a series of
13 the SFS Series Trust, an open-end management investment company organized as a
14 Delaware statutory trust on July 14, 2020, which is registered with the SEC under the
15 Investment Company Act of 1940. Hercules Investments, LLC served as
16 the investment adviser to the Hercules Fund. The Hercules Fund registration
17 statement became effective on December 15, 2020. It commenced trading on January
18 29, 2021. On September 9, 2021, the fund administrator filed a prospectus
19 supplement indicating that the Hercules Fund would be liquidated on or about
20 September 15, 2021.

21 **THE ALLEGATIONS**

22 **A. The ISA Fraud**

23 14. From May 2019 through October 2021 (“the ISA Fraud Period”),
24 McDonald solicited investors for the ISA Fund through ISA’s website.

25 15. McDonald also solicited investors from previous clients of ISA, referrals
26 from existing ISA Fund investors and Hercules employees, and by word of mouth
27 from his television appearances as a business news commentator on CNBC and other
28 business news channels.

1 16. McDonald provided ISA Fund investors with a brochure and
2 performance fee investment advisory contract. The contract also represented that ISA
3 charged a 2% annual fee plus a 20% performance fee applied to profits.

4 17. ISA's state investment adviser registrations were terminated in 2019.

5 18. McDonald continued to use the ISA name not only after the state
6 registrations were terminated, but also after ISA was rendered defunct by the Texas
7 forfeiture of its charter.

8 19. In addition, McDonald continued to provide to ISA Fund investors a
9 brochure and investment advisory contract, which falsely represented that ISA was a
10 registered investment adviser and that McDonald and ISA managed client accounts.

11 20. The ISA Fund investments offered and sold by ISA and McDonald are
12 securities because they were investment contracts.

13 21. Investors in the ISA Fund provided their money to McDonald, and
14 risked the loss of those funds from the possibility that the investment would not be
15 successful.

16 22. The ISA Fund pooled funds from investors in order to make investments
17 in the securities markets.

18 23. The fortunes of ISA Fund investors were tied to McDonald's in that the
19 ISA Fund account statements indicated that McDonald was compensated through his
20 receipt of a "financial advisor fee" for profits generated from the ISA Fund's
21 purported trading activity.

22 24. ISA Fund investors had a reasonable expectation of profits from their
23 investment that would have derived solely from the efforts of McDonald.

24 25. Once invested in the ISA Fund, the investors were entirely passive in
25 that they had no control over the use of their invested money, no ability to identify or
26 contact each other (apart from pre-existing relationships independent of their
27 investments), and no means to bring about any management changes in how the ISA
28 Fund was run.

1
2 26. While serving as the investment adviser to the ISA Fund, McDonald told
3 investors the Fund would invest in the securities markets, trading options through
4 algorithmic trading.

5 27. ISA and McDonald sent ISA Fund investors false monthly account
6 statements, which included an “ending asset allocation” that showed the investors’
7 funds were held 100% in cash at month’s end, as well as the opening and closing
8 account balances and a “cumulative return,” ostensibly from securities trading.

9 28. McDonald authored the statements sent to ISA Fund investors.

10 29. As one example, an individual agreed to invest \$420,000 with
11 McDonald in November 2019 after a series of emails and videoconference calls in
12 which McDonald told the investor that McDonald had a successful track record
13 producing returns as high as 300%.

14 30. McDonald also showed the investor charts and graphs demonstrating
15 McDonald’s trading prowess using his own algorithms to profitably trade options.

16 31. McDonald, in “Custom Portfolio Recommendation” dated November 7,
17 2019, initially represented to this individual that the individual’s money would be
18 invested in several different exchange-traded funds and high-yield corporate debt.

19 32. In early February 2020, ISA sent this investor a statement showing a
20 cash balance of over \$460,000 as of January 31, 2020, and “realized” “profit” of
21 \$29,472.68, a 6.1% monthly return.

22 33. In early March 2020, ISA sent another statement showing a cash balance
23 of over \$529,000 as of February 28, 2020, and “realized” “profit” of \$69,693.57, a
24 15.8% monthly return.

25 34. ISA and McDonald stopped sending statements to ISA Fund investors in
26 August 2021.

27 35. During the ISA Fraud Period, McDonald transferred approximately \$1.6
28 million of the amount raised from ISA Fund investors, or 45% of total investor funds,

1 to a brokerage account held in ISA's name that McDonald controlled. These were
2 the only ISA investors funds McDonald used for actual options trading.

3 36. During the ISA Fraud Period, trading in the ISA Fund brokerage account
4 produced net profits of less than \$130,000 in the aggregate, and for thirteen months—
5 from August through November 2019 and from October 2020 through May 2021—
6 there was no trading at all within the account.

7 37. The ISA Fund account mostly traded options, many of which were held
8 for periods of longer than 30 days and did not settle in cash at the end of each month,
9 contrary to what McDonald had represented to investors in the monthly statements he
10 sent.

11 38. During the ISA Fraud Period, actual profitable trading on a monthly
12 basis ranged from a low of \$1,395 to a high \$76,000, and monthly losses ranged from
13 \$56,713 to \$85,222.

14 39. McDonald also misrepresented to investors what assets the ISA Fund
15 actually held.

16 40. For example, in August 2019, ISA Fund account statements to investors
17 showed a cumulative cash balance of \$1,219,259, but ISA's brokerage and bank
18 accounts held only \$99,000 in cash.

19 41. In August 2020, the ISA Fund account statements sent to investors
20 showed nearly \$4 million held in cash, but ISA actually held just over \$215,000 in
21 cash.

22 42. In August 2021, the ISA Fund account statements sent to investors
23 showed \$2.2 million in cash, but ISA, in fact, had less than \$15,000 in actual cash on
24 hand.

25 43. McDonald commingled the ISA Fund assets with money from his
26 personal bank account and deposits from Hercules clients, a separate entity.

27 44. He misused and misappropriated the commingled funds in the following
28 approximate amounts:

- 1 (a) \$1.4 million in payments to ISA Fund investors;
- 2 (b) \$825,000 in payments to clients and/or creditors of Hercules;
- 3 (c) \$233,000 in payments to clients of ISA;
- 4 (d) \$149,000 in payments to Hercules employees; and
- 5 (e) \$1.1 million in payments for McDonald's personal expenses,
- 6 including \$301,000 for luxury vehicles, \$197,000 in shopping
- 7 charges, \$163,000 on transportation-related expenses, \$133,000
- 8 for rent on his residence.

9 45. Because payments to ISA Fund investors exceeded the cumulative ISA
10 Fund's profits, the payments ISA Fund investors were fraudulent, Ponzi-like
11 payments.

12 46. ISA Fund investors did not authorize McDonald or ISA to pay
13 McDonald's personal expenses, or to make payments to Hercules, Hercules' clients,
14 or ISA's clients.

15 47. In a phone call with an ISA Fund investor on or about November 4,
16 2021, McDonald admitted that he used the investor's money to pay off Hercules'
17 clients and creditors.

18 **B. The Hercules Fraud**

19 48. Hercules' most recent Form ADV, filed with the SEC in May 2021,
20 identified 105 clients, 144 accounts, and \$33.2 million of assets under management.

21 49. Hercules and McDonald touted McDonald's purport expertise as an
22 options trader. For example: Hercules' website, as well as documents provided to
23 clients, highlighted its active investment management, expertise in monetizing market
24 volatility, and market-hedged growth strategies used to generate "all-weather
25 performance."

26 50. Hercules's advisory clients held investment assets in brokerage accounts
27 that Hercules managed for an advisory fee.

28

1 51. Starting in mid-2020, Hercules and McDonald promoted a trading
2 strategy they claimed was designed to take advantage of anticipated market volatility
3 surrounding the 2020 presidential election and the ongoing effects of the Covid-19
4 pandemic.

5 52. In the fall of 2020, Hercules and McDonald initiated trades in client
6 accounts consistent with that strategy, but markets did not drop as Hercules and
7 McDonald expected.

8 53. By the first week of December 2020, their strategy produced realized
9 and unrealized losses in Hercules client accounts that ultimately grew to between \$30
10 and \$40 million, and as many as one-half of Hercules clients saw their account
11 balances decrease by at least 50%.

12 54. Starting in early December 2020, Hercules and McDonald initiated a
13 “loss recovery” plan to compensate clients for the massive trading losses they
14 incurred.

15 55. McDonald told clients the goal of the plan was to “restore” account
16 balances and to deter client lawsuits as well as complaints to regulators about the
17 losses, telling them this would be accomplished through trading in client accounts
18 and advisory fees generated from the Hercules Fund.

19 56. McDonald told clients that if the trading profits and fees were
20 insufficient, Hercules and McDonald would repay clients themselves.

21 57. McDonald also gave some clients a personal guarantee agreement that
22 represented he would pay the amount specified in the contract and, in the event
23 Hercules defaulted, the client could enforce the guarantee against McDonald.

24 58. Shortly after initiating the loss recovery plan, Hercules and McDonald
25 sought to raise funds from investors, including existing Hercules clients, through a
26 purported “capital raise” for Hercules and the Hercules Fund.

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1 59. Between February and October 2021 (“the Hercules Fraud Period”),
2 Hercules and McDonald raised approximately \$1.5 million from the offer and sale of
3 limited liability units in Hercules.

4 60. The Hercules units offered and sold by Hercules and McDonald are
5 securities in the form of investment contracts.

6 61. Investors in Hercules provided their money to McDonald, and risked the
7 loss of those funds from the possibility that either investment would not be
8 successful.

9 62. Hercules and McDonald pooled funds from investors allegedly in order
10 to expand Hercules’ investment adviser business.

11 63. McDonald represented to investors they would profit alongside Hercules
12 given not only his expertise as an options trader, but Hercules’ purported success
13 trading on behalf of clients and its revenue projections.

14 64. Hercules investors had a reasonable expectation of profits from their
15 investment that would have derived solely from the efforts of McDonald.

16 65. Once invested, the investors became part owners of Hercules with
17 McDonald, thus linking the investors’ fortunes to those of Hercules and McDonald.

18 66. Once invested, the investors were entirely passive in that they had no
19 control over the use of their invested money, no ability to identify or contact each
20 other, and no means to bring about any management changes in how the Hercules
21 was run.

22 67. Hercules and McDonald solicited funds from prospective investors using
23 a pitch deck, which represented that Hercules was selling up to \$20 million of its
24 equity in the form of a convertible note or equity units.

25 68. Hercules and McDonald represented that investor funds would be used
26 “to finance the expansion of the firm’s infrastructure” and to hire sales staff to
27 promote the Hercules Fund.
28

1 69. The pitch deck contained a “use of funds” provision that represented
2 investor funds would be used to “expand trading and administrative team[s],
3 employee salespeople and introducers” as well as “infrastructure, software, [and]
4 platform fees.” The pitch deck also included a “financial summary” for 2021 to 2023
5 with projected earnings (before depreciation, interest, and taxes) growing from over
6 \$17 million to over \$165 million during that period and a “valuation” in year three of
7 over \$1 billion.

8 70. Hercules and McDonald also gave prospective investors a company
9 overview that touted Hercules’ trading expertise and its successful trading on behalf
10 of clients.

11 71. Although Hercules and McDonald solicited investments from several
12 prospective outside investors, they raised funds from only one outside investor group
13 (family members who pooled their money into a single investment) that was not a
14 client of the firm.

15 72. In a recorded Zoom call on or about February 27, 2021, McDonald
16 represented that the non-client investor’s funds would not be used to operate Hercules
17 but instead to grow the business.

18 73. On another recorded Zoom call on or about March 3, 2021, McDonald
19 told this investor that each unit offered for sale was currently worth \$50,000, valuing
20 Hercules at \$50 million, which McDonald represented was “extremely below
21 market.” McDonald further represented that Hercules’ revenue projections would
22 increase from between 150% and 1,000% and the investment in the firm was “going
23 to be incrementally worth more” in the future and that the firm would soon be worth
24 “a billion dollars.”

25 74. Hercules and McDonald failed to disclose to the non-client investor that
26 (1) several Hercules clients had threatened to sue or complain to regulators over the
27 handling of their accounts and were demanding immediate repayment of their losses;
28 (2) Hercules and McDonald had promised to repay clients for trading losses of

1 between \$30 million and \$40 million; and (3) Hercules and McDonald were going to
2 use the investor's funds to repay clients for their losses.

3 75. McDonald gave the non-client investor a Hercules unit purchase and
4 operating agreement valuing one unit in Hercules at \$50,000.

5 76. On or about March 9, 2021, the non-client investor wired Hercules
6 \$675,000 as part of a planned \$1 million investment.

7 77. McDonald immediately spent the money he raised from the non-client
8 investor for both business and non-business purposes, including a March 10, 2021
9 payment of \$174,610 for a 2021 Porsche 911 Turbo S Cabriolet.

10 78. On March 12, 2021, McDonald acknowledged to the non-client investor
11 via email that McDonald's "handling of [the investor's] funds was not professional."
12 He further acknowledged "that more full disclosure of our need for the funds should
13 have been given."

14 79. In the same email, McDonald included a promissory note that he had
15 drafted to repay the investor in six months.

16 80. Hercules and McDonald also offered and sold units in Hercules to two
17 existing investment advisory clients of the firm.

18 81. Both of these clients had suffered losses in their brokerage accounts
19 managed by Hercules and McDonald.

20 82. Hercules and McDonald raised \$850,000 from the two firm clients,
21 representing that their funds would be spent on legitimate business expenses of the
22 firm.

23 83. One client, who previously sustained trading losses, attended a meeting
24 McDonald conducted where he was shown the Hercules pitch deck.

25 84. This client was offered a 4% interest in Hercules, or approximately 11
26 units, in exchange for a \$570,000 investment.

27 85. McDonald represented to this client investor that his equity investment
28 in Hercules would be used on Hercules business operations.

1 86. The other Hercules client, who also sustained trading losses in accounts
2 managed by Hercules and McDonald, transferred \$280,000 to Hercules in exchange
3 for units in Hercules worth \$1 million, or 10 units.

4 87. McDonald represented to this client that the invested funds would be
5 used by the firm to engage in securities trading.

6 88. Hercules and McDonald also offered and sold units in Hercules to two
7 other existing clients of the firm who agreed to make payments directly to other
8 clients as partial repayment for those clients' trading losses.

9 89. In early 2021, Hercules and McDonald falsely represented to those
10 clients the payments to the other clients would avert any lawsuits or complaints to
11 regulators and would enable Hercules to profitably trade and repay all client losses.

12 90. These representations were false or misleading because McDonald knew
13 or should have known such payments would not be sufficient to prevent a client from
14 filing a lawsuit or complaint against him and Hercules. In fact, in early January 2021,
15 before McDonald solicited payments from his clients, he instructed his and
16 Hercules's counsel to negotiate a settlement with at least one other client who had
17 threatened legal action over the handling of his advisory account and who, a short
18 time later, filed a lawsuit against Hercules and McDonald. McDonald knew of
19 potential lawsuits from clients as early as December 2020.

20 91. The paying clients transferred a total of \$1 million to the two other
21 clients who had threatened to sue Hercules and McDonald, or complain to regulators
22 if they were not repaid.

23 92. One paying client transferred \$224,000 in exchange for a 2% interest in
24 Hercules, or 20 units, valued—by McDonald—at \$1 million.

25 93. The other paying client transferred \$800,000 in exchange for a 5%
26 interest in Hercules.

27 94. McDonald also offered this client an additional 2% interest in Hercules
28 as compensation for his trading losses of \$252,000.

1 95. During the Hercules Fraud Period, McDonald commingled at least \$1.5
2 million of investor money with other funding sources, including \$986,000 bridge
3 financing loans made to Hercules, \$685,000 transferred from a Hercules brokerage
4 account, and \$654,000 in McDonald's personal funds.

5 96. McDonald misused and misappropriated the commingled funds in the
6 following approximate amounts:

- 7 (a) \$677,000 in payments to Hercules clients;
- 8 (b) \$738,000 in business loan repayments;
- 9 (c) \$106,000 in payments to Hercules' non-client investor;
- 10 (d) \$894,000 in transfers to Hercules brokerage account;
- 11 (e) \$645,000 in transfers to McDonald's personal account (later
12 transferred to ISA); and
- 13 (f) \$440,000 in payments for McDonald's personal expenses,
14 including \$174,000 to purchase a Porsche, \$119,000 for rent on
15 his home, credit card bills of \$63,000, cash withdrawals of
16 \$34,000, and transportation expenses of \$35,000.

17 **C. Materiality**

18 97. The ISA Fund investors would have considered it important to know that
19 ISA had been suspended as a corporation and was no longer a state-registered
20 investment adviser.

21 98. The ISA Fund investors would have considered it important to know that
22 McDonald prepared false account statements that showed non-existent trading profits
23 and funds held in cash at month's end.

24 99. The ISA Fund investors would have considered it important to know that
25 McDonald would use investor funds to pay any of the following:

- 26 (a) McDonald's personal expenses;
- 27 (b) Ponzi-like returns to ISA Fund investors;
- 28 (c) Hercules clients; or

1 (d) Hercules' business expenses.

2 100. Hercules investors would have considered it important to know that
3 Hercules had lost tens of millions of dollars for its clients, which McDonald had
4 promised to repay.

5 101. Hercules investors would have considered it important to know that
6 McDonald would use investor funds to pay any of the following:

- 7 (a) McDonald's personal expenses;
8 (b) Hercules clients for their trading losses;
9 (c) business loan repayments; or
10 (d) ISA clients and ISA Fund investors.

11 **D. McDonald Acted Knowingly, Recklessly or, at a Minimum,**
12 **Negligently**

13 102. McDonald, as the sole owner of ISA and the investment adviser to the
14 ISA Fund, knew, or was reckless in not knowing, that he was not authorized to use
15 ISA Fund investor money to pay his personal expenses, Hercules clients, or Hercules'
16 business expenses.

17 103. McDonald, as the sole owner of ISA and the investment manager of the
18 ISA Fund, knew, or was reckless in not knowing, that ISA was rendered defunct by
19 the Texas forfeiture of its charter in 2018 and ISA's state registrations as an
20 investment adviser were terminated as of May 2019.

21 104. McDonald, as the sole owner of ISA and the investment manager of the
22 ISA Fund, knew, or was reckless in not knowing, that the ISA Fund account
23 statements sent to investors were false.

24 105. McDonald, as the sole owner of ISA and the investment manager of the
25 ISA Fund, knew, or was reckless in not knowing, that returns paid to ISA Fund
26 investors were Ponzi-like payments using ISA Fund investor money.

1 106. At a minimum, McDonald acted unreasonably in using ISA Fund
2 investor money to pay his personal expenses, Hercules clients, or Hercules' business
3 expenses.

4 107. At a minimum, McDonald acted unreasonably in disseminating
5 brochures and investment advisory contracts that falsely indicated that ISA was a
6 state-registered investment adviser.

7 108. At a minimum, McDonald acted unreasonably in preparing and sending
8 false account statements to ISA Fund investors.

9 109. At a minimum, McDonald acted unreasonably in making Ponzi-like
10 payments to ISA Fund investors.

11 110. McDonald, as the sole owner and control person of Hercules and
12 the investment adviser to the Hercules Fund, knew, or was reckless in not knowing,
13 that he was not authorized to use Hercules investor money to pay his personal
14 expenses, Hercules clients, Hercules' business loans, or ISA clients and ISA Fund
15 investors.

16 111. McDonald, as the sole owner and control person of Hercules and
17 the investment adviser to the Hercules Fund, knew, or was reckless in not knowing,
18 that the Hercules clients had lost tens of millions of dollars, which McDonald had
19 promised to repay.

20 112. At a minimum, McDonald acted unreasonably in using Hercules investor
21 funds to pay his personal expenses, Hercules clients, Hercules' business loans, or ISA
22 clients and ISA Fund investors.

23 113. At a minimum, McDonald acted unreasonably in failing to disclose the
24 extent of the trading losses incurred by Hercules clients and McDonald's promises to
25 repay those losses.

26 114. Because McDonald controlled Hercules, his scienter and/or negligence
27 can be imputed to Hercules.

28

1 **E. McDonald Acted as an Investment Adviser**

2 115. At all relevant times, both McDonald and Hercules were investment
3 advisers within the meaning of Section 202(a)(11) of the Advisers Act, 15 U.S.C.
4 §§ 80b-2(a)(11), as they both, for compensation, engaged in the business of advising
5 others, either directly or through publications and writings, as to the value of securities
6 or as to the advisability of investing in, purchasing or selling securities.

7 116. McDonald was the sole owner and manager of ISA, and he received
8 compensation for giving advice to the ISA Fund.

9 **FIRST CLAIM FOR RELIEF**

10 **Fraud in the Offer or Sale of Securities**

11 **Violations of Section 17(a) of the Securities Act**

12 **(Against All Defendants)**

13 117. The SEC realleges and incorporates by reference paragraphs 1 through
14 116 above.

15 118. In the offer or sale of the ISA Fund securities, McDonald misled and
16 deceived ISA Fund investors and prospective investors by (1) falsely claiming that
17 the ISA Fund would use investor funds to profitably trade securities, (2) sending
18 investors false account statements that McDonald created which showing positive
19 account balances and investment returns, (3) claiming investor funds would be held
20 in cash at month's end, and (4) using false and misleading brochures and contracts
21 indicating that ISA was properly registered as an investment adviser when, in fact, it
22 had been suspended as a corporation and was no longer a state-registered investment
23 adviser.

24 119. In addition, McDonald engaged in a scheme to defraud whereby he
25 defrauded ISA Fund investors by making and/or disseminating false and misleading
26 statements, misused investor funds by using them to pay his personal expenses, to
27 pay Hercules clients and/or creditors, and to pay Ponzi-like returns to investors.
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1 120. In the offer or sale of the Hercules equity securities, McDonald and
2 Hercules misled and deceived Hercules investors and prospective investors by (1)
3 falsely claiming that investor funds would be used to expand the Hercules business
4 by hiring employees, marketing, and building infrastructure, and (2) failing to
5 disclose the weak financial condition of the Hercules business at the time of the
6 offering and McDonald's promises to Hercules' clients to repay their losses.

7 121. In addition McDonald and Hercules engaged in a scheme to defraud
8 whereby they defrauded Hercules investors by making and/or disseminating false and
9 misleading statements, misused investor funds by using them to pay McDonald's
10 personal expenses, Hercules clients, a Hercules loan, and by transferring investors
11 funds to ISA.

12 122. By engaging in the conduct described above, Defendants, directly or
13 indirectly, in the offer or sale of securities, by use of the means or instruments of
14 transportation or communication in interstate commerce or by use of the mails (a)
15 employed devices, schemes, or artifices to defraud; (b) obtained money or property
16 by means of untrue statements of a material fact or by omitting to state a material fact
17 necessary in order to make the statements made, in light of the circumstances under
18 which they were made, not misleading; and (c) engaged in transactions, practices, or
19 courses of business which operated or would operate as a fraud or deceit upon the
20 purchaser.

21 123. Defendants, with scienter, employed devices, schemes, or artifices to
22 defraud; and Defendants, with scienter or negligence, obtained money or property by
23 means of untrue statements of a material fact or by omitting to state a material fact
24 necessary in order to make the statements made, in light of the circumstances under
25 which they were made, not misleading; and Defendants, with scienter or negligence,
26 engaged in transactions, practices, or courses of business which operated or would
27 operate as a fraud or deceit upon the purchaser.

1 124. By reason of the foregoing, Defendants violated, and unless restrained
2 and enjoined will continue to violate, Sections 17(a) of the Securities Act, 15 U.S.C.
3 § 77q(a).

4 **SECOND CLAIM FOR RELIEF**

5 **Fraud in Connection with the Purchase or Sale of Securities**

6 **Violations of Section 10(b) of the Exchange Act and Rule 10b-5**

7 **(Against All Defendants)**

8 125. The SEC realleges and incorporates by reference paragraphs 1 through
9 116 above.

10 126. In connection with the purchase or sale of the ISA Fund securities,
11 McDonald misled and deceived ISA Fund investors and prospective investors by (1)
12 falsely claiming that the ISA Fund would use investor funds to profitably trade
13 securities, (2) sending investors false account statements that McDonald created
14 which showing positive account balances and investment returns, (3) claiming
15 investor funds would be held in cash at month's end, and (4) using false and
16 misleading brochures and contracts indicating that ISA was properly registered as an
17 investment adviser when, in fact, it had been suspended as a corporation and was no
18 longer a state-registered investment adviser.

19 127. In addition, McDonald engaged in a scheme to defraud whereby he
20 defrauded ISA Fund investors by making and/or disseminating false and misleading
21 statements, misused investor funds by using them to pay his personal expenses, to
22 pay Hercules clients and/or creditors, and to pay Ponzi-like returns to investors.

23 128. In the offer or sale of the Hercules equity securities, McDonald and
24 Hercules misled and deceived Hercules investors and prospective investors by (1)
25 falsely claiming that investor funds would be used to expand the Hercules business
26 by hiring employees, marketing, and building infrastructure, and (2) failing to
27 disclose the weak financial condition of the Hercules business at the time of the
28 offering and McDonald's promises to Hercules' clients to repay their losses.

1 129. In addition McDonald and Hercules engaged in a scheme to defraud
2 whereby they defrauded Hercules investors by making and/or disseminating false and
3 misleading statements, misused investor funds by using them to pay McDonald's
4 personal expenses, Hercules clients, a Hercules loan, and by transferring investors
5 funds to ISA.

6 130. Because McDonald, as the sole owner and control person of ISA and
7 Hercules and the investment adviser to the ISA Fund and the portfolio manager of the
8 Hercules Fund, exercised day-to-day control over these entities, he is the maker of
9 these statements to investors.

10 131. By engaging in the conduct described above, Defendants, directly or
11 indirectly, in connection with the purchase or sale of securities, by the use of means
12 or instrumentalities of interstate commerce, or the mails, employed devices, schemes,
13 or artifices to defraud; made untrue statements of material facts or omitted to state
14 material facts necessary in order to make the statements made, in the light of the
15 circumstances under which they were made, not misleading; and engaged in acts,
16 practices, or courses of business which operated or would operate as a fraud or deceit
17 upon other persons, including purchasers and sellers of securities.

18 132. Defendants, with scienter, employed devices, schemes, or artifices to
19 defraud; made untrue statements of material facts or omitted to state material facts
20 necessary in order to make the statements made, in the light of the circumstances
21 under which they were made, not misleading; and engaged in acts, practices, or
22 courses of business which operated or would operate as a fraud or deceit upon other
23 persons, including purchasers and sellers of securities by the conduct described in
24 detail above.

25 133. By reason of the foregoing, Defendants violated, and unless restrained
26 and enjoined will continue to violate, Section 10(b) of the Exchange Act, 15 U.S.C.
27 § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.
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THIRD CLAIM FOR RELIEF

Fraud by an Investment Adviser

Violations of Sections 206(1) and 206(2) of the Advisers Act

(Against All Defendants)

134. The SEC realleges and incorporates by reference paragraphs 1 through 116 above.

135. During the Hercules Fraud Period, Defendants were investment advisers within the meaning of Section 202(a)(11) of the Advisers Act, 15 U.S.C. § 80b-2(a)(11).

136. Among other things, Defendants breached their fiduciary duties to their clients by commingling, misusing, and misappropriating the funds those clients invested in the Hercules equity securities.

137. By engaging in the conduct described above, Defendants, directly or indirectly, by use of the mails or means and instrumentalities of interstate commerce, knowingly and/or recklessly: (a) employed or are employing devices, schemes or artifices to defraud clients or prospective clients; and knowingly, recklessly and/or negligently (b) engaged in or are engaging in transactions, practices, or courses of business which operated as a fraud or deceit upon clients or prospective clients.

138. By engaging in the conduct described above, Defendants violated, and unless restrained and enjoined, are reasonably likely to continue to violate, Sections 206(1) and (2) of the Advisers Act, 15 U.S.C. §§ 80b-6(1) & 80b-6(2).

FOURTH CLAIM FOR RELIEF

Fraud Involving a Pooled Investment Vehicle

Violation of Section 206(4) of the Advisers Act and Rule 206(4)-8

(Against Defendant McDonald)

139. The SEC re-alleges and incorporates by reference paragraphs 1 through 116 above.

1 140. McDonald defrauded ISA Fund investors by (1) falsely claiming that the
2 ISA Fund would use investor funds to profitably trade securities, (2) sending
3 investors false account statements that McDonald created which showing positive
4 account balances and investment returns, (3) claiming investor funds would be held
5 in cash at month's end, (4) using false and misleading brochures and contracts
6 indicating that ISA was properly registered as an investment adviser, and (5)
7 misusing and misappropriating investor funds by using them to pay his personal
8 expenses, to pay Hercules clients and/or creditors, and to pay Ponzi-like returns to
9 investors.

10 141. By engaging in the conduct described above, McDonald, directly or
11 indirectly, by engaging in the conduct described above, while acting as an investment
12 adviser to a pooled investment vehicle, directly or indirectly, by use of the mails or
13 means or instrumentalities of interstate commerce, knowingly, recklessly and/or
14 negligently: (a) made untrue statements of a material fact or omitted to state a
15 material fact necessary in order to make the statements made, in the light of the
16 circumstances under which there were made, not misleading, to any investor or
17 prospective investor in the pooled investment vehicle; or (b) engaged in acts,
18 practices, or courses of business that were fraudulent, deceptive, or manipulative with
19 respect to any investor or prospective investor in the pooled investment vehicle.

20 142. By engaging in the conduct described above, McDonald violated, and
21 unless restrained and enjoined, is reasonably likely to continue to violate, Section
22 206(4) of the Advisers Act, 15 U.S.C. § 80b-6(4) and Rule 206(4)-8 thereunder,
23 17 C.F.R. § 275.206(4)-8.

24 **PRAYER FOR RELIEF**

25 WHEREFORE, the SEC respectfully requests that the Court:

26 **I.**

27 Issue findings of fact and conclusions of law that Defendants committed the
28 alleged violations.

1 **II.**

2 Issue judgments, in forms consistent with Rule 65(d) of the Federal Rules of
3 Civil Procedure, permanently enjoining Defendants, and their officers, agents,
4 servants, employees and attorneys, and those persons in active concert or
5 participation with any of them, who receive actual notice of the judgment by personal
6 service or otherwise, and each of them, from violating Section 17(a) of the Securities
7 Act, 15 U.S.C. § 77q(a), Section 10(b) of the Exchange Act 15 U.S.C. § 78j(b) and
8 Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, and Section 206(1) and Section 206(2)
9 of the Advisers Act, 15 U.S.C. §§ 80b-6(1) & 80b-6(2).

10 **III.**

11 Issue judgments, in forms consistent with Rule 65(d) of the Federal Rules of
12 Civil Procedure, permanently enjoining McDonald and his officers, agents, servants,
13 employees and attorneys, and those persons in active concert or participation with
14 any of them, who receive actual notice of the judgment by personal service or
15 otherwise, and each of them, from violating Section 206(4) of the Advisers Act,
16 15 U.S.C. § 80b-6(4) and Rule 206(4)-8 thereunder, 17 C.F.R. § 275.206(4)-8.

17 **IV.**

18 Order Defendants to disgorge all funds received from their illegal conduct,
19 together with prejudgment interest thereon, pursuant to Exchange Act Sections
20 21(d)(5) and 21(d)(7), 15 U.S.C. §§ 78u(d)(5) & 78u(d)(7).

21 **V.**

22 Order Defendants to pay civil penalties under Section 20(d) of the Securities
23 Act, 15 U.S.C. § 77t(d), Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3),
24 and Section 209(e) of the Advisers Act, 15 U.S.C. § 80b-9(e).

25 **VI.**

26 Retain jurisdiction of this action in accordance with the principles of equity and
27 the Federal Rules of Civil Procedure in order to implement and carry out the terms of
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1 all orders and decrees that may be entered, or to entertain any suitable application or
2 motion for additional relief within the jurisdiction of this Court.

3 **VII.**

4 Grant such other and further relief as this Court may determine to be just and
5 necessary.

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7 Dated: September 21, 2022

/s/ Charles E. Canter

8 Charles E. Canter

9 Attorney for Plaintiff

Securities and Exchange Commission

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