



1 **I. BACKGROUND**

2 **A. Procedural Background**

3 The SEC’s complaint against Frost and Frost Management Company, LLC  
4 (“FMC”), filed on August 13, 2019, alleges violations of the federal securities laws in  
5 connection with five venture capital funds. (ECF No. 1 (“Compl.”)). Claim One of the  
6 Complaint asserts Fraud by an Investment Adviser, in violation of Sections 206(1) and  
7 206(2) of the Investment Advisers Act (hereinafter, “Advisers Act” or “Act”), 15 U.S.C.  
8 §§ 80b-6(1) & (2), and Claim Two asserts Fraud Involving a Pooled Investment Vehicle,  
9 in violation of Section 206(4) of the Advisers Act, 15 U.S.C. § 80b-6(4), and Rule 206(4)-  
10 8(a)(1)–(a)(2), 17 C.F.R. § 275.206(4)-8. On February 21, 2020, Frost and FMC answered  
11 the Complaint, admitting some allegations, denying others, and denying liability on both  
12 claims. (ECF No. 16 (“Ans.”)).

13 On March 26, 2021, the SEC moved for partial summary judgment as to liability and  
14 injunctive relief against Frost, arguing that nonmutual offensive collateral estoppel  
15 precluded Frost from relitigating issues that had previously been determined against Frost  
16 in an arbitration proceeding, *Matter of Frost Mgmt. Co. v. Hollencrest Bayview Partners*,  
17 JAMS No. 1200052341 (“Arbitration”). The Arbitration resulted from FMC’s demand,  
18 filed on October 17, 2016, for arbitration against investors in two funds managed by Frost  
19 entities, FMC and Frost Venture Partners, GP, LLC. (ECF No. 44-2 ¶ 61). On October  
20 12, 2021, Judge Staton, who then presided over this case, denied the SEC’s summary  
21 judgment motion. (ECF No. 118).

22 In October 2022, after the matter was reassigned to this Court, the parties filed a  
23 Stipulation pursuant to which Frost and FMC, in lieu of proceeding to trial on both claims,  
24 agreed to admit negligent liability on Claim Two. (ECF No. 157 (“Stip.”)). The Stipulation  
25 incorporates a separately filed document entitled “Admitted Facts and Admission of  
26 Liability Under Claim Two” (“Admitted Facts”). *See* (ECF No. 157-1 (“AF”) at 2). As  
27 part of the Admitted Facts, Frost and FMC have admitted that they negligently violated  
28 section 206(4) of the Advisers Act and Rule 206(4)-(8)(a)(1)–(a)(2) “by failing to act with

1 reasonable care, in accordance with applicable industry standards, in communicating with  
2 investors and prospective investors in the Funds, and in conducting the business of the  
3 Funds.” (AF 73–75).

4 The Stipulation provides the SEC, in its discretion, may file the instant Motion  
5 seeking injunctive relief and, in so doing, may argue that Frost’s and FMC’s conduct for  
6 Claim Two exceeded negligence. (Stip. ¶ 2). In opposing the Motion, Frost and FMC have  
7 agreed pursuant to the Stipulation that they are “precluded from arguing that they did not  
8 violate Section 206(4) of the Advisory Act and Rule 206(4)-8” and cannot “dispute or  
9 withdraw any of the Admitted Facts.” (*Id.* ¶ 4). Further, the Stipulation provides that “the  
10 Court may determine the Motion based on affidavits, declarations, excerpts of sworn  
11 deposition testimony taken in this action, the Admitted Facts, and documentary evidence,  
12 and may draw such inferences and find such facts as the Court deems appropriate, with or  
13 without a hearing.” (*Id.*).

14 By order dated October 31, 2022, this Court granted the parties’ Stipulation and  
15 found that Frost and FMC have “violated Section 206(4) of the Investment Advisers Act  
16 of 1940, 15 U.S.C. § 80b-6(4), and Rule 206(4)-8 thereunder, 17 C.F.R. § 275.206(4)-8, as  
17 set forth in the Admitted Facts.” (ECF No. 159). Thereafter, the SEC filed the following  
18 documents: a Motion for injunctive relief on Claim Two and declarations in support of the  
19 Motion, (ECF Nos. 160-2 to 160-5), which incorporated the filings and records in this  
20 action, including the SEC’s statement of undisputed facts in support of its previous motion  
21 for partial summary judgment and exhibits, (ECF No. 44-2); the supporting declaration of  
22 Donald Searles, (ECF No. 44-3 (“Searles Decl.”)); and exhibits attached thereto, (ECF Nos.  
23 44-4 to 44-11). In response, Frost filed an Opposition to the Motion, (ECF No. 162  
24 (“Opp.”)), in which FMC joined, (ECF No. 163). In support of the Opposition, Frost also  
25 filed a declaration, (ECF No. 162-1 (“Frost Decl.”)), and exhibits (ECF Nos. 162-2 to 162-  
26 76); the declaration of Marc Schneider, (ECF No. 162-77 (“Schneider Decl.”)), and  
27 exhibits, (ECF Nos, 162-78 to 162-96); the declaration of William Guerry, (ECF No. 162-  
28 97 (“Guerry Decl.”)), and exhibits, (ECF Nos. 162-98 to 162-106); and evidentiary

1 objections, (ECF No. 162-107 (“Frost Obj.”)). The SEC then filed a reply in support of  
2 the Motion, (ECF No. 165 (“Reply”)); the supplemental declaration of Donald Searles,  
3 (ECF No. 165-1 (“Supp. Searles Decl.”)); and a response to Frost’s objections, (ECF No.  
4 165-2 (“Obj. Response”)).<sup>1</sup>

5 Following the filing of the Motion, the Court held a series of status conferences and  
6 received supplemental briefing on several issues raised by the parties’ filings. *See* (ECF  
7 Nos. 173, 176,<sup>2</sup> 177, 182-183). In particular, the Court pointed out that the Admitted Facts  
8 amount to a high-level summary of evidence in the record without citation to the specific  
9 documents, reports, deposition testimony, or other evidence upon which they are based,  
10 asked what specific evidence served as the factual foundation for Frost’s admission of  
11 negligence liability, and questioned whether the matter should simply proceed to trial  
12 where a jury could make factual determinations, assess the credibility of witnesses, and  
13 weigh the evidence. (ECF No. 173). The Parties, however, reiterated their desire to  
14 proceed with the Motion, to have the Court determine the specific factual bases underlying  
15 Frost’s negligence liability, and to have the Court determine whether Frost’s culpability  
16 for Claim Two exceeded negligence. (*Id.*). Defense counsel argued that the parties had  
17 “jointly provided extensive stipulated facts to the Court” and had “identified, from those  
18 stipulated facts, the conduct [Frost] concedes was negligent.” (ECF No. 176 at 2).  
19 Additionally, defense counsel noted that “[t]he SEC, in support of its request for injunctive  
20 relief, presented additional argument and evidence as a putative basis for the Court to go  
21 beyond Frost’s admission of negligence and find scienter, and Frost submitted contrary  
22 evidence.” (*Id.* at 2-3). Further, defense counsel argued having a jury decide the factual  
23 issue was not necessary because, when determining whether an injunction should issue, the  
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26 <sup>1</sup> On March 28, 2023, the parties stipulated pursuant to Rule 41(a)(1)(A)(ii) to the SEC’s  
voluntary dismissal of FMC from this action. (ECF No. 167).

27 <sup>2</sup> The SEC has moved to strike Frost’s status conference statement at ECF No. 176, arguing  
28 it is an unauthorized and uninvited sur-reply. *See* (ECF No. 177). The Court has  
considered and denies that request.

1 evidence in the record was “more than the Court would have based upon a jury’s general  
2 verdict form finding Frost liable for a negligent violation of Section 206(4).” (*Id.* at 3).

3 The SEC similarly argued that both parties had “presented the Court with evidence  
4 beyond the [A]dmitted [F]acts” and that both parties “explicitly contemplated that the  
5 Court was not tied to the [A]dmitted [F]acts, and could ‘find such facts as the Court deems  
6 appropriate, with or without a hearing.’” (ECF No. 177 at 3). Overall, the parties agreed  
7 that, when determining the Motion and considering the evidence in the record, the Court  
8 would make factual findings, draw all reasonable inferences, weigh evidence, and assess  
9 credibility like a bench trial with or without an actual hearing. With that backdrop, the  
10 Court turns to the issues presented by the Motion.

### 11 **B. Frost’s Evidentiary Objections**

12 Frost raises several objections to evidence submitted by the SEC in support of the  
13 Motion.

#### 14 1. Objection to Arbitration Evidence

15 Frost objects to the admission of the following evidence from the Arbitration  
16 proceeding as being outside of the parties’ Stipulation and inadmissible hearsay:<sup>3</sup>  
17 (1) Transcripts of his testimony during day 8 of the Arbitration, (ECF No. 44-9 at 60-94);  
18 (2) the “JAMS Respondents’ Compendium of Declarations and Exhibits in Support of  
19 Requests for Punitive Damages,” which consists of declarations from investors in certain  
20 of Frost’s funds and exhibits, (ECF No. 44-10 at 1-88); and (3) the Arbitration deposition  
21 testimonies of William Guerry (“Guerry”) (ECF No. 160-2 at 49-54), Cary Breese  
22 (“Breese”) (ECF No. 160-2 at 65-69), John Burke (ECF No. 160-2 at 71-76), Doug Lawson  
23 (ECF No. 44-10 at 78-82), and Mark Lelinski (ECF Nos. 160-2 at 184-88) (collectively,  
24 “Arbitration Evidence.”).

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26 <sup>3</sup> The relevant facts and findings underlying the Arbitration were set forth in Judge Staton’s  
27 order denying the SEC’s motion for summary judgment, (ECF No. 118), which the Court  
28 incorporates by reference in this order. Approximately thirty-five (35) depositions were  
taken in the Arbitration over the course of approximately ten (10) months. *See* (ECF 44-2  
¶ 70).

1 a. *Objection Based on Stipulation*

2 Frost asserts that the parties agreed pursuant to the Stipulation that Arbitration  
3 Evidence would not be used for the Motion and represents he added the phrase “taken in  
4 this action” to the Stipulation to specifically exclude from this Court’s consideration  
5 Arbitration Evidence, including the above hearing transcripts, declarations, and deposition  
6 testimony. (Schneider Decl. ¶ 21; Frost Obj. at 6).<sup>4</sup>

7 The SEC responds that it never agreed “it would only use excerpts of ‘sworn  
8 deposition testimony taken in this action’ in support of” the Motion and points out that  
9 Frost has submitted deposition testimony from the Arbitration, including offering excerpts  
10 from the testimony of Doug Lawson while objecting to the excerpts of Lawson’s testimony  
11 offered by the SEC. (Obj. Response at 2 and n.1). Additionally, the SEC argues that the  
12 parties merely agreed that, if the SEC were to cite to any Arbitration Evidence, Frost would  
13 be free to make evidentiary objections to such evidence. (*Id.*); *see also* (ECF No. 170 at  
14 13). Further, argues the SEC, the Court should consider Arbitration Evidence because the  
15 record in this case largely consists of or is derived from Arbitration Evidence.

16 The Court, aside from the exceptions discussed below, sustains Frost’s objection to  
17 introduction of Arbitration deposition testimony insofar as it is based on the terms of the  
18 Stipulation. The Stipulation provides that the Court may determine the issues raised in the  
19 Motion based on “. . . excerpts of sworn deposition testimony taken in this action . . . .”  
20 (Stip. ¶ 4). A purely textual construction of this language demonstrates that the parties  
21 agreed to exclude from the Court’s consideration deposition testimony that was taken in  
22 connection with the Arbitration and belies the SEC’s contrary position that it never agreed  
23 “it would only use excerpts of ‘sworn deposition testimony taken in this action’ in support  
24 of” the Motion. *See* (Obj. Response at 2). Accordingly, the Court will not consider such  
25 Arbitration deposition testimony in deciding the Motion, except where Frost has “opened  
26 the door” to consideration of that evidence, as discussed next.

27 \_\_\_\_\_  
28 <sup>4</sup> Page numbers cited throughout this Order reference the relevant CM/ECF page number  
unless otherwise specified.

1 Parties, by mutual agreement, may agree to exclude consideration of certain  
2 evidence. *See, e.g., United States v. Spikes*, 158 F.3d 913, 928 (6th Cir. 1998). “Under the  
3 rule of curative admissibility, or the ‘opening the door’ doctrine, the introduction of  
4 inadmissible evidence by one party allows an opponent, in the court’s discretion, to  
5 introduce evidence on the same issue to rebut any false impression that might have resulted  
6 from the earlier admission.” *United States v. Whitworth*, 856 F.2d 1268, 1285 (9th Cir.  
7 1988). This doctrine may similarly apply where parties have agreed to exclude evidence  
8 by mutual agreement, but then one party “opens the door” on an issue by offering  
9 prejudicial or inadmissible evidence on the issue that may create a false or misleading  
10 impression if the previously excluded evidence is not admitted. *See, e.g., Spikes*, 158 F.3d  
11 at 928. Under such circumstances, the court may exercise its discretion to allow the other  
12 party to introduce previously excluded evidence on the same issue to rebut the false or  
13 misleading impression. *Id.*

14 Here, as the SEC points out, in support of his Opposition to the Motion, Frost  
15 submitted Arbitration deposition testimony for the Court’s consideration. *See* (Obj.  
16 Response at 2). Although Frost contends that he submitted Arbitration deposition  
17 testimony only “in the event that [his] objection is overruled,” (Opp. at 9 n.1), Frost has  
18 made several arguments in opposition to the Motion that rely on such evidence and/or ask  
19 the Court to draw inferences favorable to Frost from that evidence. Additionally, Frost, in  
20 support of his Opposition, has submitted declarations from himself and other witnesses  
21 and made arguments for the Court’s consideration that state facts that are inconsistent with  
22 Arbitration deposition testimony or are otherwise misleading in light of that testimony.  
23 The Court thus finds Frost’s arguments and submission of certain evidence on the topics  
24 of reasonable Incubator fees, when Frost disclosed the amount of Incubator fees to  
25 prospective investors and investors,<sup>5</sup> and what information was provided to Frost’s  
26 accountants, among other topics, have “opened the door” to the Court’s consideration of

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28 <sup>5</sup> For ease of reference, the Court’s references to investors hereinafter includes prospective  
investors where applicable.

1 Arbitration deposition testimony on those topics. *See, e.g., Aguilar v. City of Los Angeles,*  
2 853 F. App'x 92, 96-97 (9th Cir. 2021) (defendants opened the door to previously excluded  
3 contrary evidence being introduced by permitting their experts to opine on topics discussed  
4 in the excluded evidence). Without limited consideration of the specific Arbitration  
5 deposition testimony discussed in this opinion, Frost's arguments and evidence would be  
6 materially misleading as to those topics. Accordingly, insofar as Frost has "opened the  
7 door" to the introduction of contrary evidence on these issues, Frost's objection to the  
8 Court's consideration of the specific Arbitration deposition testimony discussed in this  
9 opinion is overruled.

10 As to Frost's objection to other Arbitration evidence based on the Stipulation, the  
11 Court rejects Frost's effort to read the reference in the Stipulation to "taken in this action"  
12 as precluding the Court's consideration of non-deposition evidence developed in  
13 connection with the Arbitration, including Frost's hearing transcripts, the declarations of  
14 investors, and other Arbitration evidence. *See* (Frost Obj. at 5-6). The text of the  
15 Stipulation alone, including comma placement, does not support such a broad construction.  
16 And, as argued by the SEC, the record in this case largely consists of or is derived from  
17 Arbitration Evidence. As stated previously, the Admitted Facts are a high-level summary  
18 of facts and opinions mostly extracted from documents, communications, declarations,  
19 reports, and testimony developed and/or considered in connection with the Arbitration.<sup>6</sup>

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21 <sup>6</sup> For example, Admitted Fact Nos. 45, 68, and 71 discuss the monthly fees a Frost entity,  
22 Frost Data Capital, charged to portfolio companies being fixed at a flat rate, instead of them  
23 being offered as an "a la carte" selection of adjustable services provided on a "case-by-  
24 case basis," as Frost represented to investors in marketing materials. The factual  
25 foundation for these Admitted Facts appears to include a series of email communications  
26 between Frost, Guerry, and Dean Sawyer, CEO of Sentrian, from August 6, 2015, to  
27 August 7, 2015, regarding the "prix fixe" nature of FDC's fees, as well as deposition  
28 testimony from Guerry during the Arbitration regarding the fees not being "a la carte," *see*  
Searles Decl. ¶ 100; ECF No. 44-9 at 157-159), and Frost's deposition testimony in this  
case regarding the same, *see* (Searles Decl. ¶ 101; ECF No. 44-9 at 279-281). *See, e.g.,*  
(ECF No. 162-85 ¶ 11). Additional examples include the following. *See* (AF 5, 16  
(collectively stating that Frost raised \$63 million, FDC has not been successful, and that

1 Further, witnesses deposed in this case, at times, reviewed, discussed, and referred to  
2 evidence admitted during the Arbitration and gave responses based on the Arbitrator’s  
3 findings in the final award. *See, e.g.*, (ECF No. 44-9 at 167-284). Frost also relies on  
4 Arbitration Evidence to minimize the import of some of the Admitted Facts.<sup>7</sup> The Court’s  
5 consideration of the record in this case thus necessarily requires the Court to consider some  
6 Arbitration Evidence. *See* Mot. at 3 n.1.

7 Moreover, the parties agreed pursuant to the Stipulation that, in determining the  
8 Motion, the Court could weigh evidence, make credibility findings, and decide the Motion  
9 based on evidence in the record, which includes Arbitration Evidence, with or without a  
10 hearing. *See* (ECF No. 157 ¶ 4; ECF No. 176 at 3). Thus, based on the parties’ Stipulation  
11 and the Admitted Facts, the Court’s factual findings are necessarily derived from some  
12 Arbitration Evidence, as discussed in this opinion,<sup>8</sup> except for the Arbitration evidence the  
13 Court has deemed otherwise inadmissible.

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15 “*[t]here have been no returns to the Fund or their respective investors.*”), *cf.* ECF No. 44-  
16 9 at 128 (Frost’s Arbitration deposition testimony that the funds raised \$63 million, have  
17 no cash left, and none has had an exit event that has resulted in any return to investors));  
18 (AF 66 (Frost and other FDC executives did not conduct any analysis, accounting, or  
19 market studies, or seek the advice of experts in the field in determining the reasonableness  
20 of the fees being charged to portfolio companies and whether such fees were at or below  
21 “market rate”), *cf.* ECF No. 44-9 at 108-109 (Frost’s Arbitration deposition testimony that,  
22 to his recollection, he did not conduct any analysis, consult any experts, or consult any  
23 sources to determine the reasonableness of the fees being charged by FDC or whether they  
24 were set at reasonable market rates)); (AF 15 (FDC was financially dependent on the  
25 Incubator fees), *cf.* ECF No. 44-9 at 183 (Frost testifies that FDC was financially dependent  
26 on the fees to sustain itself)).

27 <sup>7</sup> For example, Frost explains in his declaration that his representations in marketing  
28 materials that fees charged would be agreed to on a “case-by-case basis” accurately  
reflected that portfolio companies could negotiate the fees they paid as each company  
matured, and then he points to the above-referenced email communications between him,  
Guerry, and Sawyer to argue his intent was always for everyone to understand that these  
fees would be set at a flat monthly rate. *See* (Frost Decl. ¶ 38); *see also* (AF 17, 53).

<sup>8</sup> To the extent that this Order discusses other evidence generated by or considered in  
connection with the Arbitration, such as email correspondence involving Paul Cate and

1                   b.     *Objection Based on Hearsay*

2             Frost objects to the admission of his Arbitration deposition testimony as  
3 inadmissible hearsay under Federal Rule of Evidence 802, contending that it does not fall  
4 within any exception to the hearsay rule. (Frost Obj. at 6-8). Frost also argues that other  
5 witnesses' Arbitration deposition testimony, as well as investor declarations, should not be  
6 admitted under Federal Rule of Evidence 804(b)(1) because the SEC has not shown the  
7 witnesses are unavailable, Frost did not have a full opportunity to develop the testimony of  
8 these witnesses, and his motives in the Arbitration proceeding were different than they are  
9 in the present proceeding. (*Id.*).

10            As to Frost's Arbitration testimony, the SEC responds that the testimony is  
11 admissible as an opposing party's statement under Rule 801(d)(2). As to the deposition  
12 testimony of witnesses other than Frost and the declarations of investors, the SEC argues  
13 Frost's position that the SEC must show these witnesses' unavailability is inconsistent with  
14 the parties' Stipulation. Additionally, the SEC argues that the proffered testimony is not  
15 hearsay, as it is not being admitted for the truth of the matter asserted; instead, "it is simply  
16 lay opinion testimony about the reasonableness of [Frost Data Capital's] [I]ncubator fees,  
17 and the importance of other information that Frost failed to disclose to investors in the  
18 Funds . . ." (Obj. Response at 2-4). Further, the SEC asserts Frost had ample opportunity  
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22 \_\_\_\_\_  
23 DST, the Court does so either because Frost has placed such communications at issue by  
24 relying on them in declarations filed in support of his Opposition or because the  
25 communication serves as part of the factual foundation for an Admitted Fact, is an  
26 admission by Frost, or is referenced to provide context for such an admission. In the latter  
27 context, the Court has endeavored to generally omit reference to other recipients of the  
28 email and their communications in email threads, when possible. The Court notes that,  
even if it sustained Frost's objection to the admissibility of such evidence, the outcome of  
the Motion would be the same based on the Admitted Facts, Frost Declaration, the record,  
and applicable case law.

1 and similar motives in both proceedings to develop the testimony of these witnesses. (Obj.  
2 Response at 2-4).

3 The Court overrules Frost's hearsay objection to his Arbitration deposition  
4 testimony. The Court agrees that Frost's Arbitration testimony is admissible as an  
5 opposing party's statement under Federal Rule of Evidence 801(d)(2). The Court also  
6 overrules on hearsay grounds Frost's objections to admission of the deposition testimony  
7 of Guerry and Breese, insofar as the Court finds that their testimony is inconsistent with  
8 their declarations submitted in support of Frost's Opposition. *See also* Fed. R. Evid.  
9 801(d)(1)(A).

10 As to the remaining challenged Arbitration deposition testimony and investor  
11 declarations, as discussed above, except for evidence contrary to arguments and evidence  
12 submitted by Frost that the Court, in its discretion, considers to prevent the evidence  
13 submitted by Frost from being misleading, the Court sustains Frost's objection to such  
14 testimony on hearsay grounds. *See* (Frost Obj. at 6). The Court agrees that the SEC, as  
15 the proponent of such evidence, has not sufficiently satisfied its burden of demonstrating  
16 the testimony is admissible under Federal Rule of Evidence 804(b)(1).<sup>9</sup> *See* Fed. R. Evid.  
17 804(b)(1) (allowing for the use of prior deposition testimony of an unavailable witness if  
18 the party against whom the testimony is offered had a similar opportunity and motive to  
19 develop the testimony); *see also* Fed. R. Civ. P. 32(a).

## 20 2. Objection to SEC's Experts' Reports

21 Frost next objects to the expert reports of Alex Maleki and Keith Palzer. (Frost Obj.  
22 at 9). However, Frost already moved *in limine* to exclude both experts, raising virtually  
23 identical arguments before Judge Staton, who denied Frost's motion. *See* (ECF Nos. 94,  
24 95, 131). In doing so, Judge Staton found that "Maleki has identified industry standard  
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26 <sup>9</sup> The Court notes Judge Staton similarly concluded on summary judgment that Frost's  
27 different incentives and inability to develop certain deposition testimony precluded  
28 application of the collateral estoppel doctrine to the Arbitrator's findings. *See* (ECF No.  
118).

1 practices in his report” and just because “Frost disagrees there are industry standards does  
2 not provide grounds for exclusion.” (ECF No. 131 at 12). Judge Staton also found that  
3 “Maleki supplied no improper legal conclusions in ¶ 16 of his report.” (*Id.* at 13). As for  
4 Palzer, Judge Staton found that some of his opinions include improper legal conclusions,  
5 such as opining that Defendants breached their fiduciary duties. (*Id.* at 10). However,  
6 “like much of Palzer’s report, his expected testimony properly addresses industry standards  
7 regarding [I]ncubator fees, disclosure to investors, management fees, and governance  
8 norms.” (*Id.*). Judge Staton concluded that “Palzer may opine regarding industry standards  
9 and whether or not Frost’s actions deviated from those standards.” (*Id.*).

10 Frost offers no basis under the Federal Rules of Civil Procedure or the Central  
11 District of California’s Local Rules for this Court to reconsider Judge Staton’s prior order.  
12 Accordingly, the Court overrules Frost’s objection to exclude either of the SEC’s experts’  
13 reports.

### 14 3. Objection to the Canter and Searles Declarations

15 Finally, Frost objects to the declarations of Charles E. Canter and Donald W. Searles,  
16 both of whom are counsel for the SEC in this case, arguing neither Canter nor Searles can  
17 properly authenticate the exhibits attached to their declarations. (Frost Obj. at 13). The  
18 SEC responds that these exhibits were produced by Frost and therefore are deemed  
19 authentic. (Obj. Response at 5–6). The Court agrees with the SEC. *See Maljack Prods.,*  
20 *Inc. v. GoodTimes Home Video Corp.*, 81 F.3d 881, 889 n.12 (9th Cir.1996) (documents  
21 produced by a party in discovery were deemed authentic when offered by the party-  
22 opponent); 31 Wright & Miller, *Federal Practice & Procedure: Evidence* § 7105, at 39 (2d  
23 ed. 2025) (“Authentication also can be accomplished through judicial admissions such  
24 as . . . production of items in response to... [a] discovery request.”); *AFMS LLC v. United*  
25 *Parcel Serv. Co.*, 105 F. Supp. 3d 1061, 1069 (C.D. Cal. 2015) (“[M]ost of the objected-to  
26 exhibits were produced by Defendants in discovery and are deemed authentic when offered  
27 by [the opposing party].”). The Court thus overrules this objection.

1           Accordingly, based on its evidentiary rulings, the Court makes the following  
2 findings of fact and conclusions of law, which incorporate by reference the parties'  
3 Stipulation and Admitted Facts in their entirety, are based on the record in this case, and  
4 on the Court's determinations as to the relevance, credibility, weight of the evidence, and  
5 burden of proof.

## 6 **II. Factual Findings**

### 7 **A. Frost's Creation of FDC as the Incubator and FMC**

8           Before 2011, Frost founded and successfully managed two start-up, high tech  
9 companies that, through a public offering for one company and the strategic acquisition of  
10 the second by Microsoft in 2008, realized substantial financial returns to the companies'  
11 investors. (Frost Decl. ¶¶ 3-4).

12           Hoping to repeat these successes on a larger scale, in 2011, Frost founded Frost Data  
13 Capital ("FDC" or the "Incubator"),<sup>10</sup> which Frost owned, controlled, and served as its sole  
14 manager and Chief Executive Officer ("CEO"). (AF 1, 4; Frost Decl. ¶¶ 6, 8). Frost  
15 marketed to investors the concept of using FDC in his "Incubator Model." The Incubator  
16 Model entailed FDC internally identifying the technological needs of Fortune 500  
17 companies; FDC creating startup portfolio companies to develop products and solutions to  
18 meet those technological needs; and FDC providing to each startup company shared  
19 executive and other services, as well as seed investments from funds created by Frost, to  
20 assist each startup in developing its software and products. (AF 32; Frost Decl. ¶ 20; ECF  
21 No. 162-5 at 3-5; ECF No. 162-26 at 4). These efforts, Frost represented to investors,  
22 would lead to strategic "exits" by each startup company within two to five years by either  
23 the startup or its products being acquired by a "major player" in the computer industry or  
24 a Fortune 500 company, resulting in financial returns to investors. (AF 28, 32; Frost Decl.  
25 ¶ 20; ECF No. 162-5 at 3-5; ECF No. 162-26 at 4).

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27 <sup>10</sup> FDC was formally known as Frost Venture Partners, LLC, until 2014. For ease of  
28 reference, FDC in this Order refers to both FDC and, where applicable, its predecessor  
Frost Venture Partners, LLC.

1 Frost purposely designed FDC to offer an “all you can eat buffet” that, in exchange  
2 for receiving a flat monthly fee from each portfolio company, would provide shared  
3 services, access to FDC’s executives and employee staffing, and access to critical physical  
4 resources,” including office space, internet, utilities, computer hardware and software,  
5 phones, and other office supplies. (Frost Decl. ¶¶ 19, 21, 23, 25). Frost represented to  
6 investors that this Incubator Model would allow each startup to begin and continue product  
7 development until the company became attractive enough to hire an experienced internal  
8 CEO. (*Id.* ¶ 25). In the meantime, the startup could delay hiring additional executives and  
9 employees. (*Id.* ¶ 26). Frost claims he anticipated that, as a portfolio company matured, it  
10 would require less of FDC’s services and could negotiate for lower fees or terminate FDC’s  
11 services completely. (*Id.* ¶ 27).

12 In 2011, Frost also formed FMC to serve as a manager for pooled venture capital  
13 funds created by Frost to invest in FDC’s startup portfolio companies. (AF 1; Frost Decl.  
14 ¶¶ 9-10). Frost owned, controlled, and was the sole manager of FMC and served as its  
15 CEO. (AF 4; Frost Decl. ¶ 11). FMC, with Frost at the helm, ultimately served as an  
16 investment adviser for five pooled investment funds—namely, Frost VP Seed, LLC (the  
17 “Seed Fund”), Frost VP Seed International, LLC (the “International Seed Fund”), Frost VP  
18 Early Stage Fund II, L.P. (“Fund II”), FVP International Feeder Fund L.P. (the  
19 “International Feeder Fund”), and Frost Fund III, L.P. (“Fund III”) (hereinafter referred to  
20 collectively as, the “Funds”).<sup>11</sup> (Frost Decl. ¶¶ 10–16). Before FMC, Frost had no prior  
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22 <sup>11</sup> The parties have stipulated that each Fund is a “pooled investment vehicle” within the  
23 meaning of Rule 206(4)-8 of the Advisers Act [17 C.F.R. § 275.206(4)-8], *see* (AF 6), and  
24 that the limited partnership and membership interests in the Funds, as well as the shares of  
25 stock of the portfolio in which the Funds invested, are securities, (AF 36). Further, at all  
26 times relevant to the Motion, both Frost and FMC were investment advisers for the Funds,  
27 within the meaning of Section 202(a)(11) of the Advisers Act, 15 U.S.C. § 80b-2(a)(11),  
28 received compensation for advising the Funds, (AF 33, 35), and were engaged in the  
business of advising others, either directly or through publications and writings, as to the  
value of securities or as to the advisability of investing in, purchasing, or selling securities  
for compensation, (AF 33). At all relevant times, both Frost and FMC were also exempt

1 experience as an investment fund manager or investment adviser and, aside from the Funds,  
2 FMC had no other investment advisory clients. (AF 4, 7).

3 **B. Frost’s Creation of the Funds and Solicitation of Fund Investors**

4 Along with the formation of FDC and FMC, Frost created the five Funds over the  
5 course of approximately four years. (Frost Decl. ¶ 10). Frost solicited investors for each  
6 Fund using the internet, wire, and other electronic means, as well as in-person and group  
7 presentations. (AF 27; ECF No. 44-9 at 220). To market each Fund, Frost made and used  
8 PowerPoint presentations that highlighted Frost’s Incubator Model and the benefits of  
9 investing in each Fund. (AF 28). Frost also utilized pitchbooks and executive summaries  
10 that provided a high-level summary of Frost’s Incubator Model, described the investment  
11 focus and deal structure for each Fund, highlighted Frost’s relevant experience, and  
12 provided a brief description of example startup portfolio companies already being  
13 incubated by FDC at the time the presentations were made. (AF 30). With limited  
14 exception, none of these marketing materials or marketing presentations to investors before  
15 December 2015 discussed or disclosed that the portfolio companies would pay a monthly  
16 fee to FDC for its “Incubator” services. (AF 38, 67).

17 Each investor that decided to invest in a Fund memorialized the investment by  
18 signing an operating and limited partnership agreement for that Fund, which was  
19 countersigned by Frost on behalf of the particular Fund’s manager or general partner, and  
20 which designated the investor as a limited partner in the Fund. (AF 29). The investor also  
21 signed a subscription agreement confirming the investor’s eligibility and commitment to  
22 invest in the Fund. *See, e.g.*, (Frost Decl. ¶ 37; ECF No. 162-21). The operating and  
23 subscription agreements signed by Frost and each investor (collectively, the “governing  
24 documents”) governed the relationship between the Fund’s general partner and the limited

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26 reporting investment advisers pursuant to Section 203(l) of the Advisers Act, 15 U.S.C.  
27 § 80b-3(l), which provides for exemption from registration to investment advisers who act  
28 solely as an adviser to venture capital funds, (AF 2). FMC provided investment advice for  
compensation and filed reports with the SEC as an exempt reporting advisor for Funds II  
and III. (AF 34).

1 partner investors, (AF 29), and, together with the marketing materials, contained Frost’s  
2 representations to each investor regarding the material terms of the Fund’s purpose,  
3 management, operations, capital contributions, and investments. As set forth below, the  
4 provisions contained in the governing documents for each Fund were similar, but Frost’s  
5 representations to investors evolved over time.

6 1. The Seed Fund

7 In 2011, Frost created the Seed Fund with FMC serving as its manager. (Frost Decl.  
8 ¶ 12; ECF Nos. 162-8). Frost reviewed the terms of the Amended and Restated Operating  
9 Agreement for the Seed Fund (“Seed Operating Agreement”) and signed it on behalf of  
10 FMC.<sup>12</sup> (Frost Decl. ¶ 12; ECF No. 162-8 at 26; Searles Decl. ¶ 101; ECF No. 44-9 at 216,  
11 254-255). Paragraph 8.1 of the Seed Operating Agreement states that the role of FDC as  
12 the Incubator is to “incubate and develop new business” and that “[i]t is anticipated that  
13 investment opportunities in one or more businesses formed in the Incubator will be offered  
14 to the [Seed Fund] . . . .” (ECF No. 162-8 at 7). The Seed Operating Agreement neither  
15 discloses nor authorizes the use of its investment funds to pay fees to FDC for its Incubator  
16 services. (AF 64). The Seed Operating Agreement also does not disclose to investors or  
17 authorize the payment of management fees to FDC. (AF 54). Instead, Paragraph 6.1 of

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19 <sup>12</sup> The Admitted Facts and the parties’ briefs reference the Seed Fund’s “operating  
20 agreement” or “governing documents.” The SEC has not attached as an exhibit a copy of  
21 the operating agreement for the Seed Fund; instead, it points the Court for its exhibits in  
22 support of the Motion to its “statement of undisputed facts in support of its motion for  
23 partial summary judgement against Defendants (Dkt. No. 44-2), the supporting declaration  
24 of Donald W. Searles, and the exhibits attached thereto (Dkt. No. 44-3).” *See* Mot. at 3  
25 n.1. The Searles declaration, however, contains only what the SEC describes as a non-  
26 operative “draft” of the operating agreement for the Seed Fund. *See* (ECF Nos. 44-4 ¶ 8;  
27 44-4 at 279-300). In support of his Opposition, Frost has provided an Amended and  
28 Restated Operating Agreement. *See* (Frost Decl. ¶ 12; ECF No. 162-8). Both parties treat  
the Amended and Restated Operating Agreement as the operative Seed Fund Agreement.  
In fact, Frost admits in his Arbitration deposition that it is the version of the Seed Fund  
operating agreement provided to Seed Fund investors. *See* (Frost Decl. ¶ 12; ECF No. 162-  
8; ECF No. 44-9 at 216, 254-255; ECF No. 63-1 at 92). The Court thus refers to and has  
considered the document at ECF No. 162-8 as the operative Seed Operating Agreement.

1 the Seed Operating Agreement provides the Seed Fund “shall bear all operating expenses  
2 reasonably incurred by [FMC] or the [Seed Fund] in connection with the management of  
3 the [Seed Fund] and [FMC] . . . .” (ECF No. 162-8 at 4).

4 Section 11.7 of the Seed Operating Agreement provides FMC “will appoint an  
5 Advisory Committee of no less than three (3) and no more than five (5) members selected  
6 by [FMC].” (*Id.* at 12). Per the Seed Operating Agreement, the duties of the Advisory  
7 Committee include “. . . (b) upon request by [FMC], advising with respect to matters  
8 pertaining to conflicts of interest between or among [FMC], any members of [FMC], . . . or  
9 the [Seed Fund], and (c) rendering such advice and counsel as is requested by [FMC].”  
10 (*Id.*; AF 24-25). Frost, in his capacity as manager of FMC, was responsible for selecting  
11 members of the Advisory Committee. (AF 24; ECF No. 162-8 at 12-13).

12 Paragraph 11.8 of the Seed Operating Agreement provided for the creation of an  
13 Investment Committee consisting of no more than five members selected by Frost in his  
14 capacity as manager of FMC. (AF 19; ECF No. 162-8 at 13). Members of the Investment  
15 Committee were responsible for approving, by a simple majority vote, all investments  
16 presented to it by Frost in his capacity as manager of FMC, and could be removed by Frost,  
17 acting as FMC manager, at his sole discretion. (AF 20, 22-23; ECF No. 162-8 at 13). In  
18 the event of a tie Investment Committee vote, the investment decision could be made by  
19 Frost in his sole discretion, as manager of FMC, and all members of the Investment  
20 Committee were required to vote in accordance with the determination of FMC/Frost. (AF  
21 23; ECF No. 162-8 at 13).<sup>13</sup>

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22  
23 <sup>13</sup> In approximately April 2012, Frost, in his capacity as manager of FMC, created the  
24 International Seed Fund for investors outside the U.S. with FMC as its Manager. (Frost  
25 Decl. ¶ 13; ECF No. 162-9 at 9). Although the partnership agreement for the International  
26 Seed Fund discloses the existence of FDC as the Incubator, it does not disclose or provide  
27 for any fees to be paid to FDC. *See* (ECF No. 162-9). Similar to the terms of the Seed  
28 Operating Agreement, the governing documents provide that the Managing Partner “will”  
create an Advisory Committee, generally consisting of three to five members appointed by  
Frost, in his capacity as manager of FMC. The Advisory Committee would have similar  
duties as those set forth in the Seed Operating Agreement, including “advising with respect

1 The executive summary for the Seed Fund represents to investors that FDC was  
2 “formed with the expectation of starting 2-4 innovative companies per year in the big data  
3 and related spaces” to bring innovative products and solutions to market. (ECF No. 162-5  
4 at 4). Further, it represents that the Seed Fund would be entirely focused on investing in  
5 these portfolio companies. (*Id.* at 5). The executive summary also represents the  
6 following: “Note that the Seed [ ] Fund will not be expected to cover expenses and salaries  
7 incurred by [FDC], which is a completely separate corporate entity. It is expected that  
8 services provided from the [I]ncubator to the startup companies will be agreed to between  
9 the Boards of each individual company and [FDC] on a case-by-case basis, and are  
10 expected to be adjusted based on the individual needs of each company as their business  
11 matures.” (*Id.* at 6; AF 17). Additionally, the executive summary represents that the basic  
12 model for each startup company would employ several basic principles, including  
13 “[k]eep[ing] expense levels for each company relatively low in order to minimize the  
14 investment required through the life of the company. This approach generally maximizes  
15 investor returns.” (ECF No. 162-5 at 7). Similar to the Seed Operating Agreement, the  
16 executive summary for the Seed Fund represents that the Advisory Committee would be  
17 nominated from the investors in each Fund. (*Id.* at 5).

18 Frost’s PowerPoint presentation for the Seed Fund also touted to investors that  
19 investing in the Seed Fund was a “no fee” “no carry” opportunity to invest in “big data”  
20 analytics and specifically in startup companies approved by a majority of a Fund’s  
21 investment committee. (AF 28.). These startup companies would be incubated by FDC  
22 for a period while the companies developed their products and solutions with the goal of  
23 the companies being acquired within 2-5 years from their startup by “major players” in the  
24

25 \_\_\_\_\_  
26 to matters pertaining to conflicts of interest between or among [FMC], any members of  
27 [FMC], . . . or [the International Seed Fund]. (AF 24-25; ECF No. 162-9 at 13). It also  
28 similarly provides for the creation of an Investment Committee. (ECF No. 162-9 at 13-  
14). The International Seed Fund raised approximately \$636,798 from roughly 45  
investors. (AF 5).

1 computer industry or Fortune 500 companies, resulting in financial returns to the investors  
2 in the Funds. (AF 28; Frost Decl. ¶ 20).

3 In 2012, the Seed Fund raised from roughly 30 investors a total of approximately  
4 \$7,570,000, all of which ultimately was used to invest in portfolio companies and pay  
5 expenses of the Seed Fund and FDC, including Frost’s salary. (AF 5; ECF No. 160-5  
6 (“Palzer Report”) at 25-26).

7 2. Fund II

8 In approximately May 2013, Frost, through Frost Venture Partners GP, LLC (“FVP  
9 GP”), formed Fund II with Frost entity FVP GP serving as its General Partner. (Frost Decl.  
10 ¶ 14; ECF No. 162-10). At the time the Limited Partnership Agreement for Fund II (“Fund  
11 II Agreement”) was signed, Frost was a 62.5% member of FVP GP. (Ans. ¶ 16); *see also*  
12 (ECF No. 162-10 at 50). By October 21, 2016, Frost was the sole member. (Ans. ¶ 16).  
13 Frost reviewed and approved the Fund II Agreement before it was disseminated to  
14 investors. (Searles Decl. ¶ 101; ECF No. 44-9 at 224-225).

15 The Fund II Agreement represented to investors that “the primary purpose of [Fund  
16 II] is to provide a limited number of select investors with the opportunity to realize long  
17 term appreciation, generally from venture capital investments in early-stage and emerging  
18 private companies . . . that are founded and incubated by, and receive support and services”  
19 from the Incubator. (ECF No. 162-10 at 2). Paragraph 6.1 of the Fund II Agreement  
20 provides for the Fund to pay a 2% management fee to its General Partner, FVP GP. Unlike  
21 the Seed Operating Agreement, the Fund II Agreement discloses, in paragraph 6.1(d), that  
22 FDC as the Incubator “may” receive a monthly fee from each start-up or portfolio company  
23 “in exchange for certain shared advisory and support services provided to the [p]ortfolio  
24 [c]ompany.” (*Id.* at 15; AF 39). The Fund II Agreement, however, does not disclose any  
25 methodology for calculating the Incubator fees or propose a fee amount or range.  
26 Paragraph 6.1(d) represents that any Incubator fee paid by a portfolio company will “not  
27 reduce the [2%] management fee payable to the [FVP GP] . . . so long as such [Incubator  
28 f]ee does not exceed reasonable market rates.” (ECF No. 162-10 at 15)

1 Also, unlike the Seed Fund and International Seed Fund, the Fund II Agreement  
2 provides that the General Partner, FVP GP, “may” appoint an Advisory Committee, whose  
3 duties include “advi[sing] regarding matters pertaining to conflicts of interest by the [Fund  
4 II], [FVP GP] or any of the members of [FVP GP].” (*Id.* at 31; AF 24-26).<sup>14</sup> Although an  
5 Advisory Committee was established, it met on only two or three occasions, and no  
6 conflicts of interest were ever presented to it. The Fund II Agreement did not expressly  
7 provide for the appointment of an investment committee. *See* (ECF No. 162-10). Between  
8 2013 and 2014, Fund II raised approximately \$41,189,521 from roughly 74 investors, (AF  
9 5), and used all its commitments. *See* (Palzer Report at 27).

### 10 3. Fund III

11 In August 2015, Frost formed Fund III with Frost Fund III GP, LLC serving as its  
12 General Partner and FMC as a limited partner and manager. (Frost Decl. ¶ 15; ECF No.  
13 162-11 at 9). The Limited Partnership Agreement (“Fund III Agreement”) stated that the  
14 Fund’s “primary purpose . . . is to provide investors with the opportunity to realize long-  
15 term appreciation, generally from venture capital investments” in the partnership’s  
16 portfolio companies. (*Id.*). At the time of Fund III’s creation, Frost was an 81% member  
17 of the general partner and, as of December 31, 2016, Frost was the sole member. (Ans.  
18 ¶ 18).

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21 <sup>14</sup> In July 2013, Frost, in his capacity as manager of FMC, created the International Feeder  
22 Fund, with FMC serving as the general partner. (Frost Decl. ¶ 16; ECF No. 162-12). Like  
23 Fund II, the partnership agreement states its primary purpose is to provide a limited number  
24 of select investors with the opportunity to invest in the Incubator’s portfolio companies.  
25 (ECF No. 162-12 at 9). Also, like Fund II, the partnership agreement discloses that the  
26 Incubator is controlled by one or more Managing Directors, including Frost, and that the  
27 Managing Directors may also hold board seats, founder positions, and/or an equity interest  
28 in one or more portfolio company. (*Id.* at 22, 34). The agreement also provides that the  
General Partner “may” appoint an Advisory Committee with essentially the same duties as  
set forth in other Fund agreements. (*Id.* at 29; AF 24-25). Between 2013 and 2015, the  
International Feeder Fund raised approximately \$5,250,000 from roughly two investors.  
Those funds were then invested in Fund II. (AF 5).

1 Paragraph 6.1 of the Fund III Agreement provides Fund III will pay a management  
2 fee to FMC that amounts to 2% per annum, which is not subject to any contractual  
3 reduction based on reasonable market rates. *See* (ECF No. 162-11). It further discloses  
4 that each portfolio company had or would enter into agreements with the Incubator  
5 pursuant to which “each [p]ortfolio [c]ompany [would] reimburse the Incubator a monthly  
6 amount for its share of the cost of resources provided by the Incubator to the [p]ortfolio  
7 [c]ompany . . . for shared facilities, shared personnel and other shared resources.” (*Id.* at  
8 14; AF 40). As with the previous Funds, the Fund III Agreement does not disclose the  
9 methodology for calculating the Incubator fee or estimate the monthly amount of Incubator  
10 fees that would be charged to the portfolio companies, and the executive summary for Fund  
11 III is completely silent on the existence of Incubator fees. *See* (ECF No. 162-11; AF 42).

12 The partnership agreement provides that the limited partners representing a majority  
13 in interest may appoint an Advisory Committee consisting of a minimum of three investor  
14 representatives, whose duties would include advising regarding matters pertaining to  
15 conflicts of interest by Fund III, the General Partner, or any of the members of the General  
16 Partner. (AF 25; ECF No. 162-11 at 26; Frost Decl. ¶ 59). Between 2015 and 2016, Fund  
17 III raised approximately \$23,440,000, from roughly 11 investors and used approximately  
18 \$13,440,000.<sup>15</sup>

19 Again, before December 2015, none of the PowerPoint presentations to investors in  
20 the Funds disclosed that the portfolio companies would pay a monthly Incubator fee to  
21 FDC. (AF 38). When soliciting investors for the Funds, Frost repeatedly represented in  
22 marketing materials that his expectation was for FDC to create up to “2-4 innovative  
23 [startup] companies per year” whose purpose would be to develop products to meet the  
24 technological needs of big data and Fortune 500 companies with the goal of each startup  
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26 <sup>15</sup> AF 5 states that Fund III raised \$13,440,000, but the Palzer Report, which references the  
27 financial documents for Fund III, states that Fund III raised \$23,440,000 and spent  
28 \$13,440,000. (Palzer Report at 28). This discrepancy, however, is not material to the  
Court’s analysis.

1 portfolio company or its products being ultimately acquired by a big data or Fortune 500  
2 company, resulting in financial returns to investors. *See, e.g.*, (ECF No. 162-5 at 4; Frost  
3 Decl. ¶ 42; ECF No. 162-26 at 4).

4 The solicitation of investors from 2012 to 2016 resulted in Frost, through FMC,  
5 raising a total of nearly \$63 million from investors. (AF 5). The investors included high-  
6 net-worth individuals, trusts, and other “accredited” or “qualified” investors. (*Id.*); *see also*  
7 (Frost Decl. ¶ 37; ECF No. 162-21).

8 After investing in the Funds, Frost, as called for by the governing documents for  
9 each Fund, provided Fund investors with quarterly status reports regarding the Funds that  
10 generally described that quarter’s acquisitions, the status or activities of the portfolio  
11 companies in which the Funds had invested, and a valuation of the investments then held.  
12 (AF 29, 31). The quarterly reports distributed to investors did not disclose the Incubator  
13 fees paid by portfolio companies to FDC or the amount of Incubator fees charged to these  
14 Funds. (AF 63).

### 15 **C. Creation of Startup Portfolio Companies and Collection of Incubator** 16 **Fees**

17 In approximately late 2011 or early 2012, Frost and two other executives of FDC—  
18 Chief Financial Officer (“CFO”) Guerry and early FDC CFO/Chief Operating Officer  
19 Breese—discussed the amount portfolio companies should be charged by FDC for its  
20 Incubator services. (ECF No. 44-9 at 222-223; ECF No. 162-79 at 4). Both Guerry and  
21 Breese, like Frost, had extensive prior experience operating start-up companies as a CFO  
22 and CEO, respectively, and thus, according to Frost, had “good knowledge . . . of what it  
23 cost to run one of these start-ups in the early days and on an ongoing basis.” (ECF No. 44-  
24 9 at 223). Breese conducted an analysis of what he thought a reasonable Incubator fee  
25 would be, determined that amount was \$12,000 per month, and presented the analysis in  
26 Excel spreadsheet format to Frost and Guerry. (Searles Decl. ¶¶ 90, 96; ECF No. 44-9 at  
27  
28

1 13-15, 75; ECF No. 162-78 (“Breese Decl.”) ¶¶ 9, 10).<sup>16</sup> Yet, according to Guerry, the  
2 Incubator fees started out around \$25,000 per month in the earlier years and rose to around  
3 \$35,000 or \$40,000 per month as the services offered by the Incubator expanded. (Guerry  
4 Decl. ¶ 11). Frost and other FDC executives did not conduct any analysis, accounting, or  
5 market studies, or seek the advice of experts in the field in determining the reasonableness  
6 of the Incubator fees and whether such fees were at or below “market rate” when charged.  
7 (AF 66; Searles Decl. ¶ 97; ECF No. 44-9 at 108-109).

8 Further, in many instances, from the moment a portfolio company was legally  
9 formed, an Incubator service agreement would be signed by Frost, as CEO of FDC and by  
10 FDC’s CFO, Guerry. (AF 71; ECF No. 44-9 at 186-188). Although Guerry received his  
11 executive salary from FDC and reported directly to Frost, Guerry would sign the service  
12 agreement on behalf of the startup portfolio company “wearing the hat of the CFO of the  
13 specific portfolio company.” (Searles Decl. ¶¶ 97, 101; ECF Nos. 44-9 at 116-118, 187);  
14 *see, e.g.*, (Searles Decl. ¶¶ 61-62; ECF No. 44-7 at 122-128 (portfolio companies Lineage  
15 Software, Inc. and Maana, Inc. service agreements with FDC, respectively)). At the time  
16 the service agreements were signed, it was “extremely rare” to have a CEO of the portfolio  
17 company in place directing a service agreement to be signed. (ECF No. 44-9 at 186-187).  
18 Further, there were no negotiations of any of the agreements’ terms, either on a case-by-  
19 case basis or at arms-length. (AF 71; ECF No. 44-9 at 118, 187-188). The service  
20 agreements allowed FDC to immediately begin assessing Incubator fees before the  
21 portfolio company hired any executives or employees. (AF 71; ECF No. 44-9 at 115, 154-  
22 155, 186-189, 261, 264; ECF No. 162-85 ¶ 10).

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25 <sup>16</sup> In his declaration submitted in support of Frost’s Opposition to the Motion, however,  
26 Breese now represents that the number he “calculated [as] a potential starting point for the  
27 monthly [i]ncubator fees” charged by FDC to portfolio companies was \$18,000 per month.  
28 (Breese Decl. ¶ 9). Frost testified during the Arbitration proceedings that he did not  
remember the conversation with Breese occurring and that he and Breese had many  
conversations. (Searles Decl. ¶ 90; ECF No. 44-9 at 75).

1 Per the service agreements, each portfolio company paid \$25,000 to \$40,000 per  
2 month in Incubator fees for FDC's services, including some companies paying fees charged  
3 by another entity, Snow Data Capital, through FDC. (AF 12, 50-51; Frost Decl. ¶ 24; ECF  
4 No. 44-9 at 186-187). During the life of the service agreement, with few exceptions, the  
5 Incubator fees were generally nonnegotiable. (Searles Decl. ¶ 100; ECF No. 44-9 at 161).

6 The fees charged to the portfolio companies were not based on each company's use  
7 of FDC's shared facilities and personnel; instead, they were generally charged similarly  
8 across companies regardless of the needs and stage of development of the company. (AF  
9 41, 68; Frost Decl. ¶ 19; Searles Decl. ¶ 100; ECF No. 44-9 at 159). No effort was made  
10 to track or allocate the time FDC's staff spent working on tasks for each startup portfolio  
11 company. (AF 70). Additionally, unless a portfolio company successfully negotiated their  
12 fees, portfolio companies that moved out of FDC's offices paid the same fees as portfolio  
13 companies that used FDC's space, and Incubator fees were not adjusted based on the  
14 number of employees at a portfolio company. (AF 69). Further, once portfolio companies  
15 hired an executive, the shared costs typically did not decrease. (Searles Decl. ¶ 101; ECF  
16 No. 44-9 at 259-260). Finally, termination of the service agreement generally required 180  
17 days' prior written notice. *See, e.g.*, (Searles Decl. ¶ 42; ECF No. 44-7 at 22).

#### 18 **D. Frost's Creation of Snow Data Capital**

19 In 2014, Frost created and became part owner of a second Incubator-related  
20 company, Snow Data Capital ("SDC"). (AF 48, 50; Ans. ¶ 83). Per Frost, SDC was created  
21 to provide marketing services to the startup portfolio companies, *see* (AF 48, 50), but Frost  
22 also admits that it was created to provide employment to one of Frost's long-term former  
23 employees, Anthony Howcroft, who needed to be associated with SDC for immigration  
24 purposes, (AF 49; ECF No. 44-9 at 193-195). According to Frost, Howcroft was having  
25 difficulty obtaining an H-1B visa because he did not have a college degree. (ECF No. 44-  
26 9 at 194). Instead of becoming an employee of FDC, which already provided certain  
27 marketing services, Howcroft suggested to Frost "that [Howcroft] get an entrepreneurial  
28 visa by setting up Snow Data Capital," "invest[ ] an appropriate amount to qualify for that

1 entrepreneurial visa[,] and set up Snow Data Capital to work as part of the [I]ncubator.”  
2 (*Id.* at 194-195; AF 49).

3 Although FDC had generally been charging the portfolio companies for sales and  
4 marketing, beginning in approximately April 2014, SDC began charging certain portfolio  
5 companies \$5,100 per month through FDC for marketing services, in addition to the  
6 marketing fees already being charged by FDC. (ECF No. 44-9 at 145-146, 277; AF 49,  
7 51). Frost admits he never disclosed to the Funds’ investors the existence of SDC or that  
8 it was charging fees. (AF 52). Frost acknowledged that CEOs complained of the fees  
9 being charged by Snow Data Capital, including complaining, in some instances, about the  
10 competence of Anthony Howcroft. (ECF No. 44-9 at 145-146).

11 **E. Frost’s Management of the Frost Entities and Funds and His**  
12 **Compensation**

13 Frost’s management of the various Frost entities and the Funds created inherent  
14 conflicts. As previously described, Frost owned, controlled, and was the sole manager of  
15 both FMC and FDC and held an ownership interest in SDC. (AF 4, 50). FMC was the  
16 manager of the Seed Fund, the International Seed Fund, and the general partner of the  
17 International Feeder Fund. (AF 24). At its inception, Frost was the majority owner of FVP  
18 GP, which was the General Partner of Fund II, and, in 2016, Frost became the sole owner  
19 of FVP GP. (Frost Decl. ¶ 14; ECF No. 162-10; AF 24). FMC was the limited partner of  
20 Fund III, with Frost Fund III, GP, LLC serving as its General Partner, of which Frost was  
21 an 81% member at its inception and by 2016 became the sole member. (Frost Decl. ¶ 15;  
22 ECF No. 162-11 at 9; Ans. ¶ 18).

23 Frost, as a controlling owner of the managing members/partners of the Seed Fund  
24 and Fund II and member of the Funds’ investment committees determined how much these  
25 Funds invested in each portfolio company. (AF 19-23). The Funds for which Frost and  
26 FMC served as investment advisors invested substantial sums of money into FDC’s  
27 portfolio companies. (AF 7-8, 33-34). The portfolio companies were dependent upon the  
28 Funds and other investors for the capital needed to pay their Incubator fees to FDC. (AF

1 15). FDC, in turn, was financially dependent upon the Incubator fees paid by the portfolio  
2 companies because these fees were FDC's only source of revenue. (AF 15). From 2012  
3 to 2016, Frost drew a salary of at least \$3.4 million. (AF 56; Searles Decl. ¶ 101; ECF No.  
4 44-9 at 197). A portion of Frost's salary was being drawn from the Seed Fund as  
5 management services fees. (AF 55; ECF No. 44-9 at 157; Searles Decl. ¶ 44; ECF No. 44-  
6 7 at 28-29). Frost also received compensation, in part, from investments from other Funds  
7 in portfolio companies, which were used to pay Incubator fees to FDC from which Frost,  
8 in turn, drew a salary and was entitled to share in FDC's profits. (AF 56). As discussed  
9 below, Frost also received compensation in the form of FDC paying for certain of his  
10 personal expenses. (AF 57). These compensation arrangements, among others, resulted  
11 in inherent conflicts of interest between Frost, FDC, FMC, and the Funds.

12 Although in his capacity as manager of FMC and in his capacity as majority owner  
13 of Fund II, Frost had the ability to appoint an Advisory Committee to advise the Seed Fund  
14 and Fund II on conflicts, only Fund II established an Advisory Committee. (AF 24-26;  
15 ECF No. 162-5 at 5). The Advisory Committee only met on two or three occasions, and  
16 no conflicts of interest were presented. (AF 26).

17 The governing documents for the Seed Fund, Fund II, and Fund III each also contain  
18 a provision for the creation of an Investment Committee, the responsibility of which would  
19 be to approve all investments presented by Frost in his capacity as manager of FMC. *See*  
20 (Frost Decl. ¶¶ 20, 45). According to Frost, once Frost and his team decided to start a new  
21 portfolio company, the matter would be submitted to a Fund's Investment Committee,  
22 which determined how many portfolio companies would be created and how much a Fund  
23 would invest in each newly created company. (AF 60; Frost Decl. ¶ 49). When voting on  
24 funding for new portfolio companies, Frost contends the Investment Committees took the  
25 process seriously, actively debated on the worth of the potential investment, rejected or  
26 postponed some investments, and declined to approve some investments. (Frost Decl.  
27 ¶¶ 53-55); *see also* (ECF Nos. 162-79 at 4-6; 162-81 at 3-5; 162-83 at 4-6). However, the  
28 Seed Fund's Investment Committee membership were all employees of and paid by FDC—

1 though the membership varied over time—and Fund II and Fund III’s investment  
2 committee consisted exclusively of FDC insiders and always included Frost. (AF 21); *see*  
3 also (Frost Decl. ¶ 47; ECF No. 44-9 at 204-205). Further, Frost was the only member of  
4 Fund III’s Investment Committee in late 2016 and was thus solely responsible for  
5 approving the Fund’s investment in the last two newly formed portfolio companies. (AF  
6 61). Also, members of the Seed Fund’s Investment Committee could be removed by Frost,  
7 in his capacity as manager of FMC, at his sole discretion. (AF 22). Additionally, although  
8 all actions of the Seed Fund’s Investment Committee required at least a majority vote of  
9 its members, in the event of a tie vote, the investment decision would be made by Frost in  
10 his sole discretion, as manager of FMC, and all members of the Investment Committee  
11 would be required to vote in accordance with the determination of the manager, i.e., Frost.  
12 (AF 23; Frost Decl. ¶ 56).

13         According to Frost, he addressed actual and potential conflicts of interests created  
14 by his management of the Funds and interests in the various Frost entities, in part, by  
15 wearing different metaphorical hats. During the ideation phase, Frost wore his hat as head  
16 of the Incubator deciding whether to form a portfolio company. (Searles Decl. ¶ 101; ECF  
17 No. 44-9 at 240). As he explained, “[FMC] played no role in the ideation or formation of  
18 the company . . . . So at that point I’m wearing my hat as the [General Partner (“GP”)] of  
19 the fund. So my role as a GP of the fund is managing the fund’s investments, sitting on  
20 boards on behalf of the GPs, because the fund is only involved in a company once it’s  
21 making an investment, not before that.” (Searles Decl. ¶ 101; ECF No. 44-9 at 239). Per  
22 Frost, in his role as General Partner of the Funds, Frost would also sit on the board of  
23 portfolio companies representing the Fund’s investment. (Searles Decl. ¶ 101; ECF No.  
24 44-9 at 238). In his position as an investment committee member of the Funds, Frost made  
25 the determination to invest Fund money into various portfolio companies “[w]earing the  
26 hat of an investment committee member . . . .” (Searles Decl. ¶ 101; ECF No. 44-9 at 232).  
27 Members of the Investment Committee for the Seed Fund were also members or employees  
28 of FDC and received compensation from FDC. (Searles Decl. ¶ 101, ECF No. 44-9 at 204-

1 205, 274). Frost testified, “I was very careful to think about the different hats I wore and  
2 we didn’t approve every deal, that’s for sure,” and that other members of the investment  
3 committees that also worked for FDC “were performing their roles at that stage as GPs, as  
4 part of the [I]ncubator . . . and took into consideration and wore different hats just the  
5 same.” (Searles Decl. ¶ 101; ECF No. 44-9 at 272).

## 6 **F. Management Fees and Frost’s Personal Expenses**

### 7 1. *Frost’s Management Fees*

8 The governing documents for the Seed Fund and the International Seed Fund did not  
9 disclose or authorize the payment of management fees. (AF 54). The executive summary  
10 of the Seed Fund also represented to investors that the Seed Fund would not be expected  
11 to cover “expenses and salaries incurred by FDC . . . .” (AF 52). Yet, from 2012-2014,  
12 FMC charged the Seed Fund \$324,280 and the International Seed Fund \$24,875. (AF 55).<sup>17</sup>  
13 From June 2012 through September 2013, Frost charged the Seed Fund \$16,000 per month,  
14 totaling \$256,000, for his salary at FDC, which was listed in FMC’s books as “management  
15 services.” *See, e.g.*, (Searles Decl. ¶ 44; ECF No. 44-7 at 28-29); *see also* (Searles Decl.  
16 ¶ 100; ECF No. 44-9 at 157 (Guerry testifying that Frost’s salary was, in fact, covered by  
17 the Seed Fund)). These facts were not disclosed to investors in the Seed Fund and  
18 International Seed Fund.

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19  
20  
21 <sup>17</sup> The context of the Admitted Facts suggests, but does not make clear, whether these  
22 amounts constituted “management fees” paid from the Seed Fund and International Seed  
23 Fund. The Admitted Facts also do not make clear whether Frost’s \$16,000 was included  
24 in the amounts set forth in Admitted Fact 55 or in addition to those amounts. However,  
25 the Expert Report of David Weekly dated October 13, 2017, suggests Frost’s total salary  
26 amount of \$256,000 for the period of June 2012 to September 2013 was part of the  
27 \$324,280 paid by the Seed Fund, although the Seed Fund “Management fund expenses”  
28 number in the Weekly report differs from the Admitted Facts number. *See* (ECF No. 160-  
4 (“Weekly Decl.”) at 32). Further, according to the 2017 Weekly Expert Report, “Frost  
stopped charging the Seed Fund for his salary in October 2013, because he was able to  
collect management fees from Fund II.” (*Id.*).

1 Frost reasoned that, because FDC was, in effect, operating the Seed Fund at the time,  
2 FDC could charge for operating expenses, some of which were used to cover Frost's salary  
3 because he was performing those services. (Searles Decl. ¶¶ 100-101; ECF No. 44-9 at  
4 201-202, 246); *see also* (ECF No. 160-2 ("Cantor Decl.") ¶ 8; *id.* at 52-53 (William Guerry  
5 testified that Frost stated that \$16,000 a month should be charged to the Seed Fund as  
6 Frost's compensation, which Guerry classified as a management fee being paid by the Seed  
7 Fund, instead of being paid by FDC)).

8 The governing documents for Fund II stated that FDC "may" receive a monthly  
9 service fee from portfolio companies and stated that the service fee would not reduce the  
10 2% management fee paid to FDC, so long as the fee did not exceed "reasonable market  
11 rates." (AF 39). During the period that Frost managed Fund II, Frost received an allocated  
12 portion of the 2% management fee. (Frost Decl. ¶ 86). Further, at the time Fund II was  
13 created, Frost's salary at FDC jumped from \$250,000 to \$1.2 million, which was not  
14 disclosed to investors of Fund II. (Searles Decl. ¶ 101; ECF No. 44-9 at 248-249).

15 The governing documents for Fund III stated that the portfolio companies would  
16 reimburse FDC a monthly amount for its share of the costs of resources provided by FDC  
17 for shared facilities, shared personnel, and other shared resources. (AF 40). Fund II and  
18 Fund III cumulatively paid management fees totaling over \$1.7 million. (AF 47).  
19 According to the Weekly Declaration, the Incubator fees were not set at market rate, were,  
20 in fact, excessive, and therefore should have reduced Fund II's 2% management fee to zero  
21 pursuant to the language of Fund II's governing documents. (Weekly Decl. at 12  
22 (concluding that the Funds paid \$12,798,195 in excessive Incubator fees to FDC through  
23 December 31, 2017, including \$9,413,262 in excessive fees paid by Fund II which should  
24 have been deducted from Fund II's management fees); ECF No. 160-3 ("Maleki Decl.") at  
25 11-14 (FDC's practice of charging flat rate Incubator fees regardless of company need  
26 violated industry standards and resulted in payment of excessive fees by portfolio  
27 companies to FDC)).

1                   2.     *Frost's Personal Expenses*

2             Although not entirely clear, it appears that FDC paid for certain costs incurred by  
3 Frost that likely amount to personal expenses. Specifically, FDC paid over \$867,000 for  
4 several of Frost's expenses including a wine locker, archery range, boat payments, and a  
5 beach club membership, as well as Frost's personal chef, housekeeper, lease payments on  
6 luxury cars, and payments for charges (averaging a total of \$18,000 a month) made on  
7 personal credit cards. (AF 57). After FDC paid for the personal chef, housekeeper,  
8 automotive lease payments, and payments for charges made on personal credit cards, it  
9 reduced the compensation paid to Frost to cover the expenditures. (AF 57). According to  
10 Frost, his housekeeper was an employee of FDC because Frost, for a time, was working  
11 from home and the housekeeper certainly cleaned his home office. (Searles Decl. ¶ 96;  
12 ECF No. 44-9 at 63). According to Guerry, the rent charged to each portfolio company at  
13 some point also included charging for Frost's personal archery range rent. (Searles Decl.  
14 ¶ 101; ECF No. 44-9 at 149-153).

15             Frost did not disclose to investors in the Funds that FDC was paying for the salary  
16 of Frost's personal chef, but Frost claimed his salary was reduced as a result. (Searles  
17 Decl. ¶ 101; ECF No. 44-9 at 265-266). Also, certain of Frost's expenses paid by FDC,  
18 including expenses for his Ferrari, Yacht, and Black Card, were reimbursed by FVP GP  
19 and deducted from Frost's allocation of management fees paid to FVP GP by Fund II.  
20 (Searles Decl. ¶ 45; ECF No. 44-7 at 31); *see also* (Searles Decl. ¶ 49; ECF No. 44-7 at 44  
21 (email from Guerry to Frost summarizing Frost's personal expenses deducted from Frost's  
22 share of net management fees, including lease of a Ferrari, bungalow deposit, yacht deposit,  
23 and \$125K for Air Partners, a private chartered jet)).

24             At times, however, there appeared to be a lag in reimbursement of those fees from  
25 FVP GP, resulting in FDC carrying the expense at least for a time. For example, in a series  
26 of emails starting August 21, 2014, Shital Patel, Controller of FDC, and Guerry discussed  
27 the forecast for FDC. (Searles Decl. ¶ 50; ECF No. 44-7 at 44). In response to Guerry's  
28 inquiry regarding whether certain cash had been moved, Patel wrote in an August 25, 2014,

1 email that “[t]he GP owed the [I]ncubator \$148K of expenses (there was a wire for the  
2 yacht that I had missed when we spoke).” (Searles Decl. ¶ 50; ECF No. 44-7 at 52). In an  
3 email dated August 26, 2014, Guerry responded to Patel, “[a] few questions, I thought with  
4 the transfer of \$60K from the GP to the [I]ncubator we would have had more cash in the  
5 [I]ncubator. Why isn’t that the case?” (Searles Decl. ¶ 50; ECF No. 44-7 at 51). The same  
6 day, Patel responded via email to Guerry, stating. “[t]he [I]ncubator doesn’t have more  
7 cash because we picked up the \$100K expense for air partners. This expense was not  
8 reflected in the forecast previously. Cash balance is \$49K . . . . I updated the spreadsheet  
9 to show the formula . . . . The spreadsheet is considering . . . [Frost’s] \$15K September  
10 villa in payment . . . .” (Searles Decl. ¶ 50; ECF No. 44-7 at 51).

11 Moreover, certain emails between Frost and Guerry suggest Frost simply allocated  
12 how his expenses should be paid, resulting in those expenses being paid by FDC from its  
13 Incubator fee proceeds. For example, on July 25, 2014, Frost sent an email to Guerry  
14 stating, “We need to pay the balance for the boat. This should be split equally between  
15 John and me.” (Searles Decl. ¶ 49; ECF No. 44-7 at 44). The same day, Guerry responded  
16 via email to Frost, “I will have this paid today. Note that currently you have already used  
17 up your GP fee allocation for the year with the \$125K deposit last month for the airplane.  
18 . . . Did you see my email re: blackcard? I assume there was some one-time travel costs  
19 and that level of expense won’t be recurring as we won’t have enough in the [I]ncubator to  
20 cover.” (Searles Decl. ¶ 49; ECF No. 44-7 at 44).

### 21 **G. Frost’s Undisclosed Motivation for Creating Portfolio Companies**

22 As stated previously, Frost represented in the Seed Fund governing documents and  
23 marketing materials that FDC would start only “2-4” big data software portfolio companies  
24 per year to develop products and solutions to meet the technological needs of big data and  
25 Fortune 500 companies with the goal of strategic acquisition of each portfolio company or  
26 its products. *See* (ECF No. 162-5 at 4; Ans. ¶ 93). Yet, between 2012 and 2016, FDC  
27 founded 24 portfolio companies, 12 of which were created between April 2014 and  
28 February 2015. (AF 9, 11; Ans. ¶ 93; Searles Decl. ¶ 101; ECF No. 44-9 at 191). The

1 portfolio companies were funded by the Funds, along with other high net worth individuals,  
2 trusts, and affiliates of public companies. (AF 10). Contrary to Frost’s representations to  
3 the Funds’ investors, email communications between Frost and other executives at FDC  
4 demonstrate that Frost’s motivation for creating more portfolio companies was not solely  
5 to develop products and solutions to meet the technological needs of big data and Fortune  
6 500 companies for strategic acquisition, but, instead, to generate more Incubator fees and  
7 cashflow and reduce costs incurred by FDC, which Frost operated on a break-even basis.  
8 (AF 14, 58; Ans. ¶ 93). For example, on April 8, 2014, Frost wrote to Guerry regarding  
9 Fund II’s cashflow, stating, “[j]ust for kicks – Can you do a refresh of the fund cashflow  
10 assuming 12 new companies between now and July?” (Searles Decl. ¶ 47; ECF No. 44-7  
11 at 39). In response, on April 9, 2014, Guerry stated, “[g]iven the current expect closing, I  
12 would be hesitant in doing more than 6-8 companies at this time. I think 12 would be a big  
13 stretch for us.” (Searles Decl. ¶ 47; ECF No. 44-7 at 39).

14 On May 20, 2014, Guerry sent an email to Frost providing him the recent forecasts  
15 for the Funds and FDC. As to FDC, Guerry informed Frost, “[r]ight now we need 2 more  
16 companies to cover out [sic] costs (with Genie coming out in June).” (Searles Decl. ¶ 48;  
17 ECF No. 44-7 at 42). In an email dated July 11, 2014, Guerry wrote, “[a]s of my last  
18 budget forecast, we were running a bit tight given the lack of a second new company in the  
19 latest batch. We might make up for that with others, but haven’t yet . . . . I am ok with  
20 doing it, assuming we get 2 more companies providing [I]ncubator fees, can rely on GE  
21 funding, and believe we will still get another \$10 million of funding.” (Searles Decl. ¶ 71;  
22 ECF No. 44-8 at 131). Similarly, in an email to Frost dated March 29, 2015, regarding  
23 FDC and fund forecasts, Guerry wrote, “[w]e are still a bit stretched in the [I]ncubator. We  
24 need one more company in order to cover the plan for the rest of the year . . . . The split  
25 between the [I]ncubator and Snow [Data Capital] has the [I]ncubator making enough to  
26 cover the shortfall in Snow . . . .” (Searles Decl. ¶ 51; ECF No. 44-7 at 55). Additionally,  
27 in an email dated September 24, 2015, from Guerry to Frost, with a subject line “Incubator  
28 Forecast,” Guerry wrote, “[h]ere is the updated forecast thru 9/30. We will draw \$20-30K

1 on the LOC this month to make it. That will leave \$40-50K available. We really need to  
2 start a couple of companies.” (Searles Decl. ¶ 75; ECF No. 44-8 at 145).

3 On June 8, 2016, in an email to Guerry, John Vigouroux, and Miles Mahoney, with  
4 a subject line of “plan,” Frost wrote as to FDC, “we need to urgently secure as much  
5 funding as possible across the portfolio while retaining as much cash flow as possible for  
6 the [I]ncubator. If we can find funding, starting a few new companies is still  
7 possible . . . . New companies would be incredibly helpful in terms of [I]ncubator cash  
8 flow. Also, they would create opportunities for [I]ncubator staff and execs.” (Searles Decl.  
9 ¶ 81; ECF No. 44-8 at 166). Similarly, in an email dated June 10, 2016, Frost told Guerry:  
10 “It’s critically important to get the [I]ncubator to break even ASAP. To achieve this we  
11 need to 1. Retain as much income as possible from the existing companies. We all need to  
12 do whatever we can to sell the value of the [I]ncubator’s services to the companies that  
13 have funding. . . 3. Start a few new companies ASAP . . . with DST fund investment . . .  
14 4. Move costs to the newcos [new portfolio companies] by assigning some of our  
15 [I]ncubator execs as CEO/CTO.” (AF 58; Searles Decl., ¶ 54; ECF No. 44-7 at 68; Ans.  
16 ¶ 98).

## 17 H. Reaction to Incubator Fees

### 18 1. *Fund Investors*

19 Frost stated both in his Arbitration testimony and in his deposition in this action that  
20 when Fund investors inquired about the amount of FDC’s Incubator fees, Frost generally  
21 would not disclose the requested information. *See* (ECF No. 44-9 at 86-89, 228, 230).  
22 According to Frost, however, he and other executives at FDC did describe to some  
23 investors the Incubator fees in general terms as being roughly the cost of a “fully burdened  
24 executive” or “fully loaded executive” that would be hired by a start-up company, *see*  
25 (Frost Decl. ¶ 41); *see also* (Guerry Decl. ¶ 17; Searles Decl. ¶ 97; ECF No. 44-9 at 120,  
26 226-227, 257), without providing a specific number for the charged fees, (ECF No. 44-9 at  
27 135-136). Neither Frost’s nor Guerry’s declaration states when they began making such  
28 references to investors, but Frost acknowledged in his deposition testimony he did not

1 recall or was unaware of any such language being used in the operation agreements for the  
2 Seed Fund, Fund II, in subscription agreements, or marketing materials for these two  
3 Funds; nor did he recall them being included in any other documents that were provided to  
4 investors before December 2015.<sup>18</sup> *See* (ECF No. 44-9 at 135-136, 139). Moreover, the  
5 phrase “fully burdened cost of one senior executive,” or similar phrase according to SEC  
6 industry standards expert, Keith Palzer, has no common industry meaning. (Palzer Report  
7 at 67-68).

8 At other times, says Frost, he and other executives communicated the approximate  
9 costs in dollars to investors, but he does not pinpoint the approximate date such disclosures  
10 began.<sup>19</sup> (Frost Decl. ¶ 42). The Court notes, however, that the evidence Frost points to in  
11 the record of a dollar amount disclosure is dated December 2015, *see* (Frost Decl. ¶ 42;  
12 ECF No. 162-26 at 9; Guerry Decl. ¶ 19; ECF No. 162-100), and it does not provide any  
13 methodology for calculating the amount of the Incubator fees noted. Moreover, as the SEC  
14 points out, a disclosure in December of 2015 would have been well after “the vast majority  
15 of investor monies were raised.” *See* Mot. at 12 n.3.

16 The specific amount of shared Incubator fees being paid by the portfolio companies  
17 was, in Frost’s view, confidential, and limited partner investors were not entitled to that

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18  
19 <sup>18</sup> In support of his Opposition, Frost submitted the declaration of Luis A. Vasquez, the  
20 former Vice President of Investor Relations for FDC, who claims he was present at many  
21 investor meetings with Frost, John Vigouroux, and others where the fact that Incubator fees  
22 would be charged and the amount of Incubator fees to be charged at the rate of a fully  
23 burdened executive, approximately \$35,000-\$40,000 per month, was disclosed to  
24 investors. (ECF No. 162-94 ¶ 5). Vasquez does not, however, provide a timeframe for  
25 when such meetings took place, nor does he specify which Fund had the investor meetings,  
26 which investors were present, or what specific representations were made, among other  
27 details.

28 <sup>19</sup> Frost attaches to his declaration a prospective investor PowerPoint presentation he  
represents was made to DST that lists on slide 8 “Shared Services Allocation (\$40k/mo.\*).”  
(Frost Decl. ¶ 42; ECF No. 162-26). The annotation for the asterisk states “[a]mount shall  
decline as the number of companies in the portfolio increases,” *see (id.)*. Notably, Frost  
has not pointed to any evidence in the record demonstrating the monthly amount charged  
to each portfolio company decreased based on the number of companies in the portfolio.

1 information. *See* (Searles Decl. ¶ 101, ECF No. 44-9 at 149-151, 157-158). At the same  
2 time, Frost and FDC executives took the position that Fund investors were “sophisticated,”  
3 institutional investors, some of whom had reviewed and commented on marketing  
4 presentations before they were given, and that these investors thus understood that the  
5 portfolio companies would be paying Incubator fees. (Frost Decl. ¶¶ 37, 39; Guerry Decl.  
6 ¶ 13); *see also* (ECF No. 162-87 (“Jordan Decl.”) at 13 (“In order to subscribe to a private  
7 fund offering, an investor must affirm that s/he has sufficient investment sophistication,  
8 financial resources, and understanding of the terms and conditions of the investment  
9 opportunity as specified in the offering documents.”)). Moreover, claims Frost, if these  
10 investors wanted to know about the fees and specific amounts charged for FDC’s services,  
11 they could look at the marketing materials or just ask for more information. (Opp. at 11;  
12 Frost Decl. ¶ 37; Guerry Decl. ¶ 16).

13 As an example of additional information being provided to an investor who  
14 requested it, Frost submits an email thread beginning in November 2014 in which Paul  
15 Cate, an investor, asked for more detailed financials, as well as an explanation for a line  
16 entry in a portfolio company’s financials that listed “Frost Expense” next to the amount of  
17 \$36k per month paid by the portfolio company to FDC. (Guerry Decl. ¶ 21; ECF No. 162-  
18 102 at 2). On March 2, 2015, in a follow-up email to Guerry, Cate stated, “I never got an  
19 answer to [the November 20, 2014] e-mail.” (ECF No. 162-102 at 2). On March 3, 2015,  
20 Guerry apologized for the delay and responded, in part, that “the cost is a share of Incubator  
21 resources that are shared by all of the Frost portfolio companies . . . .” (*Id.*). Although,  
22 Guerry provided examples of the services provided by FDC, he did not provide a break-  
23 down of the amounts charged for each service or methodology used to calculate the fees.  
24 *See (id.)*. After subsequently receiving another request in 2016 from Cate for financials  
25 and details as to “all amounts paid to related parties,” Luis Vasquez, who at the time was  
26 Vice President of Investor Relations for FDC and was responsible for responding to  
27 investor inquiries, wrote an email dated March 1, 2016, to Guerry stating, “FYI - I believe  
28 that at some point, you will need to discuss the [I]ncubator fee with [Cate]. Or at least tell

1 him that you're not providing the information.” (ECF No. 162-94 ¶ 4; Searles Decl. ¶¶ 76,  
2 96; ECF Nos. 44-8 at 147-148). On March 4, 2016, Guerry wrote an email to Frost  
3 “bringing [Frost] in the loop” regarding Cate’s inquiries. Guerry stated, “We have giving  
4 [sic] him information he has requested but not in enough detail for him to be able to  
5 separate out the related party payments ([I]ncubator fee).” (ECF No. 44-8 at 147-148).

6 Further, when some Fund investors learned about the actual amount of Incubator  
7 fees being charged to startup portfolio companies, they voiced their concern to Frost. DST  
8 invested in Fund III and, following receipt of DST’s funds, Fund III invested \$522,000 in  
9 startup portfolio company Pinscriptive. At least \$83,000 of the funds was used by  
10 Pinscriptive to pay down loans it owed to FDC for Incubator fees, another \$36,000 was  
11 used to pay Incubator fees invoiced on April 15, 2016, and another \$5,100 was used to pay  
12 SDC fees. (Weekly Decl. ¶ 7). Mark Lelinski, the CEO of Pinscriptive, wrote an email to  
13 Frost on July 27, 2016, telling Frost “DST will be PISSED if they find out you gave us  
14 \$500k and within days we used \$200k to pay Frost for ‘phantom past debt.’” (Searles Decl.  
15 ¶ 64; ECF No. 44-8 at 17; Canter Decl. at 185-87 (“phantom debt” referred to accrued,  
16 unpaid Incubator fees when Pinscriptive was “hibernating”). Subsequently, in an email  
17 dated February 27, 2017, from Tom Giles to Frost, Giles wrote, “Dst is still not  
18 understanding the approval of 2 new co’s without any approval process beyond [Frost] and  
19 what fees are being used for if no employees in companies.” (Canter Decl. at 180). Then,  
20 by letter dated March 22, 2017, from Randall Young, Senior Vice President, General  
21 Counsel, and Secretary of DST, Young requested to have a meaningful in person  
22 discussion with Frost and stated that it was first necessary to set forth in the letter DST’s  
23 “genuine concerns and what changes need to occur in order for the Fund [III] to have a  
24 chance to be successful in meeting the objectives for which it was created.” (Searles Decl.  
25 ¶ 69; ECF No. 44-8 at 122). Young also wrote, “DST is shocked about the size and  
26 frequency of the ‘management fee’ being charged by your management company in  
27 relation to the limited, if any, value being added to the process. Until such time as the cash  
28 required for activities of the Fund are not stressing the prospects for success, the

1 ‘management fees’ charged and collected by your organization should be either waived all  
2 together or, at the very least, held in arrears. As you should know, ideation companies such  
3 as this cannot take on the burden of excessive expenses, such as your management fees,  
4 and still be successful . . . .” (*Id.*).

5 2. *Portfolio Company Executives*

6 Although some portfolio company executives believed they received good value for  
7 the services received from FDC, at least as to certain stages of their development, *see* (Frost  
8 Decl. ¶ 31; ECF No. 162-82 at 3-4), several CEOs of the startup portfolio companies voiced  
9 their concern to Frost and other FDC executives over Incubator fees, (AF 43). According  
10 to Breese, FDC’s CFO until approximately March 2012, Incubator fees being too high  
11 “was a very common complaint from other CEOs” and some voiced concern that the fees  
12 were affecting their ability to fundraise. (Searles Decl. ¶ 90; ECF No. 44-9 at 18); *see, e.g.*,  
13 (ECF No. 44-9 at 54-55 (Mark Lelinski testifying that when he became the CEO of  
14 portfolio company Prinscriptive, he obtained the company’s financials and learned  
15 approximately \$60,000 of an initial \$250,000 Fund investment had already been paid out  
16 during two prior months for Incubator fees and was concerned that the loss of these funds  
17 would impact the company’s progress); ECF No. 162-85 ¶ 11 (John Burke, Chairman and  
18 CEO of portfolio company UBIX, communicated with “Frost and Guerry about reducing  
19 [I]ncubator fees charged to UBIX” and “requested more transparency in the [I]ncubator  
20 fees,” but was told by Frost the Incubator model was “not set up with a list of services from  
21 which a company could pick and choose which ones they wanted to take advantage of in  
22 any given month”);<sup>20</sup> ECF No. 44-8 at 150 (in an email dated April 22, 2016, from Richard  
23 Sootkoos of portfolio company Pingthings to Guerry, which Guerry forwarded to Frost,  
24 Sootkoos wrote, “[o]n March 2nd, you wired \$42k to the [I]ncubator at the expense of our  
25 operations knowing that we had only weeks of runway left. I told you twice to wire the  
26 money back immediately after, the same day. You responded that Frost would work with

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27  
28 <sup>20</sup> Nor has the Court been provided with any such information concerning how fees were  
calculated or service costs shared among the Portfolio companies.

1 us if and when we ran out of cash. That time is now. . . . Wiring back the \$42K to our  
2 account is what needs to happen at this point”)).

3 In August 2015, Dean Sawyer, the CEO of portfolio company Sentrian, emailed  
4 Frost requesting that a requisite 180 days’ notice for discontinuing Incubator fees be  
5 reduced to 30 days’ notice so that Sentrian could move toward full-time rather than shared  
6 resources. Frost responded, “I know that Bill [Guerry] has explained to you that FDC does  
7 not offer its services on some kind of a la carte basis. It’s prix fixe only. That will not  
8 change just because you’d like it to.” (Searles Decl. ¶ 60; ECF No. 44-7 at 116; AF 45).  
9 Sawyer responded, in part, that he thought the prix fixe model might become more flexible  
10 over time based on the changing needs of the more mature portfolio companies, but since  
11 that was not the case, he was giving formal 180 days’ notice to end the service agreement.  
12 (Searles Decl. ¶ 60; ECF No. 44-7 at 116).

13 Although a few of the portfolio companies’ CEOs were able to renegotiate the terms  
14 of their service agreements, *see* (ECF No. 162-85 ¶ 12; AF 44; Frost Decl. ¶ 28), it was not  
15 without great difficulty and such successful negotiations appear to have been the exception,  
16 not the rule. Of the few portfolio companies that were able to renegotiate the amount of  
17 fees being paid to FDC, the reason typically was either because the company could not  
18 make payroll or because an outside investor insisted on a reduction. During his Arbitration  
19 deposition testimony, Frost discussed his position on reducing fees as follows, “[a]s I said,  
20 at the end of the day, wearing that hat as the CEO of the [I]ncubator, I would negotiate  
21 hard. That was my job. . . . And the CEO would play his role of wearing his hat there and  
22 negotiating on behalf of the company. And in the end we would resolve that negotiation  
23 to some -- you know, in some way. Some cases I convinced them that the fee should stay  
24 where it was. Many other cases it was reduced, depending on the circumstances.” (Searles  
25 Decl. ¶ 101; ECF No. 44-9 at 243).

### 26 **I. Incubator Fees’ Impact on Portfolio Companies**

27 Over the course of its business, FDC charged the portfolio companies more than  
28 \$19,000,000 in fees. (AF 13). The portfolio companies depended on the Funds and other

1 investors for the capital needed to pay their requisite Incubator fees. (AF 15). Frost admits  
2 the Incubator fees indisputably weakened the financial condition of the FDC’s portfolio  
3 companies and negatively impacted their ability to raise capital. (AF 15, 46).  
4 Notwithstanding its charging of Incubator fees, FDC was ultimately unsuccessful; the  
5 Funds and their respective investors received no financial returns on their investments. (AF  
6 16). As of early 2018, only a few of the portfolio companies remained active. (AF 16).  
7 Of the 24 portfolio companies associated with FDC, 14 never generated revenue and the  
8 few remaining companies have generated minimal revenue. (Weekly Decl. at 26; Searles  
9 Decl. ¶ 73; ECF No. 44-8 at 137-39 (email dated June 30, 2015, from Steve Gotz, an  
10 employee of FDC, to Frost, noting there had been 15 companies founded since 2014, 67%  
11 of which “are exhibiting/have exhibited exceptionally poor execution,” reflecting  
12 “unacceptably high failure rates and instances of poor execution” and recommending to  
13 “[r]ight-size/stratify the monthly [Incubator] fee, to more accurately reflect the value we  
14 are capable of delivering for our companies”). In short, contrary to the representations of  
15 Frost to Funds investors, Funds investors generally did not receive financial returns on their  
16 investments in the startup portfolio companies incubated by FDC.

### 17 **III. LEGAL STANDARD**

#### 18 **A. Nature of Proceedings**

19 Generally, a district court may grant injunctive relief on a summary judgment record,  
20 but “cannot resolve any genuine factual issue, including credibility and must resolve all  
21 factual inferences against the moving party and in favor of the opposing party.” *SEC v.*  
22 *Husain*, 70 F.4th 1173, 1180 (9th Cir. 2023) (internal quotations and alterations omitted).

23 Here, however, the Court is not presented with a summary judgment record. Instead,  
24 the parties have agreed to the Admitted Facts and stipulated that Frost is liable for a  
25 negligent violation of Section 206(4) of the Act and Rule 206(4)-8. (AF; ECF No. 159).  
26 The Parties also agreed the SEC, in seeking an injunction, can argue, consistent with the  
27 allegations in Claim Two of the Complaint, that Frost’s admission of negligence is merely  
28 the floor of his liability. *See* (Complaint ¶¶ 126-130). Additionally, the Parties agreed that

1 Frost is free to argue that his liability does not exceed negligence and that injunctive relief  
2 is not appropriate. (ECF No. 170 at 31-32). Further, the Parties have stipulated the Court  
3 “may determine the issues raised in the [M]otion on the basis of affidavits, declarations,  
4 excerpts of sworn deposition testimony taken in this action, the Admitted Facts, and  
5 documentary evidence, and may draw such inferences and find such facts as the Court  
6 deems appropriate, with or without a hearing.” (ECF No. 157 ¶ 4). Finally, since executing  
7 the Stipulation, the Parties have repeatedly reiterated that the Court may determine factual  
8 disputes presented by the Motion without resort to an evidentiary hearing or full trial. *See*  
9 (ECF Nos. 170 at 31-32; 176 at 3; 179 at 2; 182 at 8; 183). Thus, the rule announced in  
10 *Husain* presents no obstacle to the Court’s resolution of the SEC’s pending motion for  
11 injunctive relief.<sup>21</sup>

12 Indeed, neither party disputes that the Court, in determining the issues in the Motion,  
13 is not required to review the facts in a light most favorable to Frost, as the non-moving  
14 party. *See, e.g.*, (Opp. at 18–19 (discussing applicable legal standard)); *cf. Husain*, 70 F.4th  
15 at 1180 (holding that, to determine whether to issue injunctive relief on a summary  
16

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17 <sup>21</sup> Even if the Court were deciding this matter on a summary judgment record, this would  
18 not preclude the Court from making findings of fact, drawing inferences, and weighing the  
19 credibility of witnesses without the requisite summary judgment presumptions, so long as  
20 the parties agreed to that procedure, as is the case here. *See, e.g., Gillespie v. Norris*, 231  
21 F.2d 881, 883-84 (9th Cir. 1956) (holding, on summary judgment, that where “plaintiff  
22 made many admissions, but also made qualified denials which raised questions of fact,”  
23 but parties acquiesced in the procedure of submitting documents, affidavits, and admissions  
24 to the court for factual determination on the evidence, the parties waived jury trial regarding  
25 the questions of fact); *Starsky v. Williams*, 512 F.2d 109, 112 (9th Cir. 1975) (although the  
26 parties had filed cross-motions for summary judgment, “the parties in fact agreed that all  
27 of the underlying material facts were those reflected by the written record before the court”  
28 and, “[g]iven the unique procedural history of litigation, . . . the court was justified in  
concluding that the parties had in effect and in substance agreed to a trial of the [ ] claim  
on the written record”); *accord Acuff-Rose Music, Inc. v. Jostens, Inc.*, 155 F.3d 140, 142-  
43 (2d Cir.1998) (“We today adopt the position of our sister circuits that a district court  
may decide a case by summary bench trial upon stipulation of the parties as long as the  
parties have willingly foregone their right to a full trial.”)

1 judgment record, a district court must determine whether genuine issues of material fact  
2 exist and must resolve any uncertainty in favor of the non-moving party). Nor do the  
3 parties argue that any of the genuine disputes of fact that apparently exist concerning  
4 scienter, good faith, and Frost's contrition preclude the Court from deciding the SEC's  
5 Motion without an evidentiary hearing or trial per the parties' Stipulation. Accordingly,  
6 while it may be inappropriate at summary judgment for a court to question a party's good  
7 faith conduct to determine whether the party's violation of the act demonstrates scienter,  
8 *see Husain*, 70 F.4th at 1184-85, the Parties in this case have repeatedly affirmed their  
9 mutual desire for the Court to make that assessment on the record before it.

10 **B. The Advisers Act**

11 Section 206(4) of the Advisers Act prohibits investment advisers from directly or  
12 indirectly engaging in "any act, practice, or course of business which is fraudulent,  
13 deceptive, or manipulative." 15 U.S.C. § 80b-6(4). Rule 206(4)-8(a) provides:

14 It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of  
15 business within the meaning of Section 206(4) of the Act . . . for any investment  
16 advisor to a pooled investment vehicle to:

17 (1) Make any untrue statement of a material fact or to omit to state a material  
18 fact necessary to make the statements made, in light of the circumstances in  
19 which they were made, not misleading, to any investor or prospective investor  
in the pooled investment vehicle; or

20 (2) Otherwise engage in any act, practice, or course of business that is  
21 fraudulent, deceptive, or manipulative with respect to any investor or  
22 prospective investor in the pooled investment vehicle.

23 17 C.F.R. § 275.206(4)-8(a).

24 "A fundamental purpose" of Congress passing the Advisers Act "was to substitute a  
25 philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high  
26 standard of business ethics in the securities industry." *SEC v. Cap. Gains Rsch. Bureau,*  
27 *Inc.*, 375 U.S. 180, 186 (1963). The Advisers Act is "to be construed like other securities  
28

1 legislation enacted for the purpose of avoiding frauds, not technically and restrictively, but  
2 flexibly to effectuate its remedial purposes.” *Id.* at 195 (internal quotations omitted).

3 To effectuate its purposes, the Advisers Act authorizes the SEC to seek penalties and  
4 injunctive relief for violations. 15 U.S.C. § 80b-9(d). The Act provides that a court “shall”  
5 grant a permanent or temporary injunction “[u]pon a showing that such person has  
6 engaged, is engaged, or is about to engage in any such act or practice” constituting a  
7 violation of the Act. 15 U.S.C. § 80b-9(d).

8 To obtain an injunction, the SEC must establish that there is a reasonable likelihood  
9 of future violations of the securities laws. *See SEC v. Murphy*, 626 F.2d 633, 655 (9th Cir.  
10 1980) (“*Murphy I*”). “The existence of past violations may give rise to an inference that  
11 there will be future violations; and the fact that the defendant is currently complying with  
12 the securities laws does not preclude an injunction.” *Id.*

13 In “predicting the likelihood of future violations,” the court must assess “the totality  
14 of the circumstances surrounding the defendant and his violations.” *Id.* To do so, the court  
15 weighs and considers the following five factors: (1) the degree of scienter involved; (2) the  
16 isolated or recurrent nature of the infraction; (3) the defendant’s recognition of the  
17 wrongful nature of his conduct; (4) the likelihood, because of defendant’s professional  
18 occupation, that future violations might occur; and (5) the sincerity of his assurances  
19 against future violations. *Id.* (citation omitted). “No single factor is determinative; instead,  
20 the district court should determine the propensity for future violations based on the totality  
21 of the circumstances.” *SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1228 (D.C. Cir.  
22 1989). The “purpose of injunctive relief against violators of the securities laws is to deter  
23 future violations, not to punish the violators.” *SEC v. Randolph*, 736 F.2d 525, 529 (9th  
24 Cir. 1984) (citation omitted). Ultimately, “[t]he granting or denying of injunctive relief  
25 rests within the sound discretion of the trial court.” *SEC v. Fehn*, 97 F.3d 1276, 1295 (9th  
26 Cir. 1996) (internal quotations and citation omitted).

1 **IV. DISCUSSION**

2 The Court has considered evidence relevant to its determination of the likelihood of  
3 future violations and, in accordance with the parties’ Stipulation and where appropriate,  
4 has resolved some factual disputes to do so. Based on the Court’s assessment of the  
5 evidence submitted, as relevant to the following five factors, and the reasonable inferences  
6 it has drawn from that evidence, the Court finds that the totality of the circumstances in  
7 this case demonstrates an injunction is warranted.

8 **A. First Factor: The Degree of Scierter Involved**

9 To establish a violation of Section 206(4), the SEC need only prove the defendant  
10 acted with negligence. *See SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992) (holding  
11 scierter not required for Section 206(4)); *SEC v. Alar*, No. 1:19-CV-03265-JPB, 2022 WL  
12 953310, at \*9 (N.D. Ga. Mar. 30, 2022) (“Sections 206(2) and 206(4) do not require  
13 scierter; ‘a showing of negligence is sufficient.’” (quoting *ZPR Inv. Mgmt. Inc. v. SEC*,  
14 861 F.3d 1239, 1247 (11th Cir. 2017))). “Negligence is the failure to exercise ordinary  
15 care.” *SEC v. Duncan*, No. 3:19-cv-11735-KAR, 2021 WL 4197386, at \*8 (D. Mass. Sept.  
16 15, 2021).

17 Pursuant to the parties’ Stipulation and the Admitted Facts, Frost admits that he  
18 violated Section 206(4) and Rule 204(4)-8 by acting negligently while serving as an  
19 investment advisor to the Funds. Thus, Frost admits that he “engaged in an act, practice,  
20 or course of business that was fraudulent, deceptive, or manipulative” by making a  
21 statement of material fact that was not true and/or was misleading due to the omission of a  
22 material fact, to an investor or prospector of the Funds. (AF 74; *see also* ECF No. 159).

23 Frost, however, argues an injunction may not issue based only on a showing of  
24 negligence. *See* (Opp. at 19–20 (“Frost’s lack of scierter alone defeats an injunction”).  
25 The Court disagrees. Federal courts may issue an injunction upon the showing of a  
26 violation of the securities laws. *See, e.g.*, 15 U.S.C. §§ 77t(b), 78u(d), 80b-9(d). Indeed,  
27 the Supreme Court has instructed that “a district court may consider scierter *or lack of it*  
28 as one of the aggravating or mitigating factors to be taken into account in exercising its

1 equitable discretion in deciding whether or not to grant injunctive relief.” *Aaron v. SEC*,  
2 446 U.S. 683, 701 (1980) (emphasis added). Moreover, the Ninth Circuit has upheld  
3 injunctions where the SEC did “not allege” intent to defraud because the “degree of  
4 scienter” was “not necessary to prove” the type of past violation alleged in the case. *Fehn*,  
5 97 F.3d at 1296; *see SEC v. Gault*, 751 F. App’x. 974, 980 (9th Cir. 2018) (rejecting  
6 argument that “negligence is ‘not enough’ to support an injunction” against future  
7 negligent violations of Section 17(a)(3) and explaining that, “[a]lthough scienter must be  
8 proved before an injunction may issue ‘when scienter is an element of the substantive  
9 provision sought to be enjoined,’ the SEC is not required to establish scienter to enjoin  
10 violations of provisions ‘such as § 17(a)(2) and § 17(a)(3), which may be violated even in  
11 the absence of scienter’” (quoting *Aaron*, 446 U.S. at 701)). As such, this Court is not  
12 precluded from enjoining a negligent violation of the Advisory Act.<sup>22</sup>

13       Regardless, the issue of whether a negligence finding is sufficient to issue an  
14 injunction is of no moment because, as discussed below, the Court finds that Frost’s  
15 statements and actions in violating Section 206(4) and Rule 204(4)-8(a)(1) and (a)(2)<sup>23</sup>  
16 were not merely negligent, as he admits, but rose, at a minimum, to the level of  
17 recklessness.

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18  
19 <sup>22</sup> Frost cites *Steadman*, 967 F.2d at 648, as an example where the D.C. Circuit overturned  
20 imposition of an injunction in part because it reversed the scienter-based claims despite  
21 affirming defendants’ violations of Section 206(4). (Opp. at 20). However, the misconduct  
22 at issue in *Steadman* was far less deliberate than Frost’s actions here. In *Steadman*, the  
23 court denied a permanent injunction where the violators were merely “negligent in failing  
24 to add a single footnote about potential liability.” *Steadman*, 967 F.2d at 648. As discussed  
25 in this Order, the extent, duration, and deliberate nature of Frost’s conduct goes beyond  
26 mere negligence.

27 <sup>23</sup> Frost relies on the fact that he stipulated to an admission of liability for a negligent  
28 violation of Section 206(4) of the Advisers Act. According to Frost, the SEC could have  
but did not insist upon an admission of scienter and instead settled for an admission of  
negligence, thereby suggesting that the SEC recognizes it cannot prove scienter. (Opp. at  
19–20). However, as the SEC points out, the SEC did not stipulate that Frost’s conduct  
was *only* negligent; “rather, negligence is all that Frost must admit for purposes of  
establishing his liability under Section 206(4) and Rule 206(4)-8.” (Reply at 3 n.2).

1           1.     Untrue and Misleading Statements and Fraudulent, Deceptive, and  
2                     Manipulative Acts

3           Aside from Frost’s admissions in the Stipulation and Admitted Facts, the Court finds  
4 that Frost made untrue and misleading statements to investors and otherwise engaged in  
5 acts, practices, and courses of business that were fraudulent, deceptive, or manipulative,  
6 including, but not limited to, the following. First, as to the Seed Fund, Frost made several  
7 statements that he knew or should have known were untrue or misleading. For example,  
8 in marketing presentations, Frost represented to investors that the Seed Fund was a “no-  
9 fee, no-carry” fund. (AF 28; ECF No. 162-5 at 5). And the Seed Fund’s governing  
10 documents represented to investors only that the Fund would bear the operating expenses  
11 reasonably incurred by it and FMC in connection with the management of the Fund and  
12 FMC. (ECF No. 162-8 at 4). These documents and presentations did not disclose that  
13 investment funds would be used to pay FDC’s or Frost’s management fees or expenses.  
14 (AF 54; ECF No. 162-5 at 6). Yet, because Frost was drawing his salary from FDC—  
15 approximately \$192,000 in 2012 alone, *see* (Frost Decl. ¶ 82)—and the Incubator fees were  
16 the only source of FDC’s revenue, FDC’s management fees, and the salaries and expenses  
17 incurred by FDC personnel, were being paid, at least in part, from investments in the Seed  
18 Fund.<sup>24</sup> (AF 54, 64; ECF No. 162-5 at 6); *see also* (AF 55 (stating that from 2012-2014,  
19 FMC charged the Seed Fund \$324,280 and the International Seed Fund \$24,875); Searles  
20 Decl. ¶ 44, ECF No. 44-7 at 28-29; Searles Decl. ¶ 100, ECF No. 44-9 at 157 (Guerry  
21 testified that Frost salary was, in fact, covered by the Seed Fund)).<sup>25</sup>

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22  
23 <sup>24</sup> Although Frost attaches a Seed Fund executive summary transmitted to Mike Schulman  
24 of Hollencrest, which references portfolio companies being charged on a case-by-case  
25 basis for services from the Incubator, the summary does not disclose the amount of fees,  
26 and Frost admits such fees were not negotiated on a case-by-case basis or through arm’s  
27 length transactions. *See* (AF 71). Further, it is unclear whether all investors received the  
28 executive summary, and the fees were still not disclosed in the governing documents for  
the Seed Fund. *See* (Palzer Report at 51).

<sup>25</sup> Frost explained that, because the Incubator was, in effect, operating the Seed Fund at the  
time, it charged for operating expenses, some of which were used to cover Frost’s salary

1 Second, although the Seed Operating Agreement and an executive summary  
2 represented that Frost, through FMC, would establish an Advisory Committee nominated  
3 from the investors in the Seed Fund to, among other tasks, render advice “with respect to  
4 matters pertaining to conflicts of interest between or among [FMC], any members of  
5 [FMC], . . . or the [Seed Fund] . . . ,” (ECF Nos. 162-8 at 12; 162-5 at 5; AF 24-25), Frost  
6 never established an Advisory Committee for the Seed Fund. As previously found,  
7 inherent conflicts of interest existed between Frost and the Funds based on Frost’s  
8 management of FDC and the various Frost entities, his role in creating portfolio companies,  
9 his role in making investment decisions through the Fund’s Investment Committee, and his  
10 role serving as an investment advisor to the Funds, as well as based on his compensation  
11 arrangements paid at least in part from FDC’s receipt of Incubator fee payments from  
12 portfolio companies. *See* (Frost Decl. ¶ 87 (Frost admits he “did not effectively manage  
13 the conflicting economic pressures of operating the Incubator while acting as an advisor to  
14 the Funds”). As such, Frost’s representation to investors in the governing documents for  
15 the Seed Fund that an Advisory Committee would be established to assess and advise the  
16 Fund regarding conflicts such as his was not true or, at the very least, was misleading.

17 Third, as to Fund II, the governing documents for Fund II disclosed to investors that  
18 FDC “may” receive a monthly service fee from the companies in which the partnership  
19 holds an investment in exchange for certain shared advisory and support services provided  
20 by FDC. *See* (AF 39). Frost did not disclose in the governing documents that Incubator  
21 fees were, in fact, being and would continue to be charged by FDC to the portfolio  
22 companies. Indeed, the record reveals that Incubator fees generally were charged from the  
23 moment a portfolio company was formed, even if the newly created company had no CEO  
24 or employees. *See* (AF 67). And Frost has not pointed to any evidence in the record where

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25 \_\_\_\_\_  
26 because he was performing those services. (Searles Decl. ¶¶ 100-101, ECF NO. 44-9 at  
27 201-202, 246); *see also* (Cantor Decl. ¶ 8; *id.* at 52-53 (William Guerry testified that, Frost  
28 stated that \$16,000 a month should be charged to the Seed Fund as Frost’s compensation,  
which Guerry classified as a management fee being paid by the Seed Fund, instead of being  
paid by FDC)).

1 FDC refrained from executing a service agreement assessing a monthly service fee to a  
2 newly formed portfolio company as a going concern. As such, Fund II’s use of the term  
3 “may” in its governing documents was deceptive. *See Robare Grp., Ltd. v. SEC*, 922 F.3d  
4 468, 475-76 (D.C. Cir. 2019) (holding under Sections 206(1) and 206(2) a disclosure that  
5 a fee “may” be collected is inadequate when the adviser knows fees are in fact collected);  
6 *SEC v. Blavin*, 760 F. 2d 706, 708-09, 711 (6th Cir. 1985) (concluding that “a disclaimer  
7 that the investment advisor ‘may’ trade in recommended securities for its own account is  
8 itself a material misstatement”).

9 Fourth, although the governing documents for Fund II disclosed FDC may receive a  
10 monthly service fee, they did not disclose that the execution of the service agreements  
11 imposing such fees typically were not negotiated, let alone at arm’s length, or that the  
12 agreements obligated the portfolio companies to typically pay between \$25,000 to \$40,000  
13 a month in Incubator fees to FDC using Fund II’s investments. *See* (AF 15). Paragraph  
14 6.1(d) of the Fund II Agreement represented to investors that any Incubator fee paid by a  
15 portfolio company would “not reduce the [2%] management fee payable to the [FVP  
16 GP] . . . so long as such [Incubator f]ee [did] not exceed reasonable market rates.” (ECF  
17 No. 162-10 at 15; AF 39). It did not disclose, however, that no periodic calculation or  
18 market studies would be conducted or industry standards or experts in the field consulted  
19 to determine whether the monthly \$25,000 to \$40,000 Incubator fees being charged to  
20 portfolio companies were at reasonable market rates, *see* (AF 66; Frost Decl. ¶ 24), and  
21 thus Frost and FDC also could not determine whether the 2% management fee being  
22 charged to Fund II at any given time should be reduced.<sup>26</sup>

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23  
24 <sup>26</sup> The parties heavily dispute whether the Incubator fees exceeded “reasonable market  
25 rates,” warranting a reduction in the management fee. Each has submitted its own series  
26 of expert reports on the issue. According to the Weekly Report, the Incubator fees were  
27 not at market rate, were, in fact, excessive, and therefore should have reduced Fund II’s  
28 2% management fee to zero pursuant to the language of Fund II’s governing documents.  
(Weekly Decl. at 12 (concluding that the Funds paid \$12,798,195 in excessive Incubator  
fees to FDC through December 31, 2017, including \$9,413,262 in excessive fees paid by  
Fund II, which should have been deducted from Fund II’s management fees); *see also*

1 Nor did Frost disclose to investors his conflicts of interest, as set forth above, or his  
2 acts, practices, and course of business of self-dealing. Further, although Frost did establish  
3 an Advisory Committee for Fund II, the committee did not operate as the governing  
4 documents represented it would because it did not receive any disclosures about the  
5 Incubator fees paid by the portfolio companies or their amounts, (AF 65), let alone address  
6 the self-dealing nature and conflicts of interests regarding such fees.

7 Fifth, the governing documents for Fund III, formed in approximately August of  
8 2015, represented to investors that the portfolio companies in which the Fund invested  
9 would reimburse FDC a monthly amount for its share of the cost of resources provided by  
10 FDC for shared facilities, shared personnel, and other shared resources. (AF 40; Frost  
11 Decl. ¶¶ 14-15, ECF Nos. 162-10, 162-11). When making the representations in the  
12 governing documents for Fund III, Frost did not disclose to investors that such fees were  
13 fixed and not based on each portfolio company's allocation of shared services. Nor did  
14 Frost disclose to investors the precise methodology FDC used to calculate the monthly,  
15 fixed fee. *See* (Searles Decl. ¶ 101, ECF No. 44-9 at 149-151). However, when  
16 communicating with the portfolio companies around the same time frame, Frost maintained  
17 that Incubator fees were fixed and would not change. For example, in a series of email  
18

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19 (Maleki Decl. at 11-14 (FDC's practice of charging flat rate Incubator fees regardless of  
20 company need violated industry standards and resulted in payment of excessive fees by  
21 portfolio companies to FDC)); *but see* (Jordan Decl. at 23-30 (opining that Incubator fees  
22 were not excessive)). Whether Frost is able in hindsight to demonstrate that the monthly  
23 Incubator fees of approximately \$25,000 to \$40,000 were set at reasonable market rates  
24 does not change the fact that he has admitted he "failed to act with reasonable care, in  
25 accordance with industry standards" in communicating with investors in the Funds and had  
26 not consulted industry experts or conducted any marketing studies to determine reasonable  
27 market rates before setting the Incubator fees. Thus, he could not legitimately assess  
28 whether the 2% management fee being charged to Fund II should be reduced based on the  
Incubator fee rates being charged by FDC. The Court finds that knowing Frost lacked the  
requisite information to determine both whether the 2% fee should be reduced and whether  
the Incubator fees were set at reasonable market rates is information that would have been  
material to a reasonable investor in Fund II.

1 communications between Frost, Guerry, and Dean Sawyer, CEO of portfolio company  
2 Sentrion, from August 6, 2015, to August 7, 2015, Frost stated to Sawyer, “I know that  
3 [Guerry] has explained to you that FDC does not offer its services on some kind of a la  
4 carte basis. It’s prix fixe only. That will not change just because you’d like it to.” (Searles  
5 Decl. ¶¶ 60, 100; ECF No. 44-7 at 116-119; ECF No. 44-9 at 157-159, 279-281; AF 45).  
6 Thus, Frost’s representations to investors of Fund III regarding FDC’s fees being allocated  
7 based on each portfolio company’s allocation of shared services were false or misleading.

8 Sixth, the governing documents and marketing materials for the Seed Fund, Fund II,  
9 and Fund III represented to investors that the reason portfolio companies in which the  
10 Funds invested would be created and incubated would be to develop their technological  
11 products with the goal of attracting major players for strategic acquisition of the startups,  
12 resulting in financial returns to the Funds’ investors. *See* (AF 32; ECF Nos. 162-5 at 3-5;  
13 162-10 at 2; 162-11 at 9; 162-26 at 4; Ans. ¶ 45). From 2012 through 2016, Frost was also  
14 representing in marketing materials to investors that the goal of FDC was to launch “up to  
15 2-4 [I]ncubator companies per year” for that purpose. (ECF No. 162-26 at 4); *see also*  
16 (ECF No. 162-5 at 4 (stating, in 2012, “Frost VP has been formed with the expectation of  
17 starting 2-4 innovative companies per year in the big data and related spaces.”)). However,  
18 contrary to his representations, Frost created 12 of the 24 portfolio companies between  
19 April 2014 and February 2015. (Ans. ¶ 93; Searles Decl. ¶ 101, ECF No. 44-9 at 191).  
20 Further, from Frost’s communications with other executives at FDC and his admissions, it  
21 appears Frost’s motivation for doing so was not solely to attract major players for strategic  
22 acquisition to increase returns to Fund investors but, instead, primarily to generate more  
23 Incubator fees, cashflow, and reduced costs for FDC. (AF 14, 58; Searles Decl. ¶¶ 48, 51,  
24 71, 75; ECF No. 44-7 at 42, 55; ECF No. 44-8 at 131, 145). As such, Frost’s  
25 representations to investors regarding the Incubator Model’s purpose were deceptive.

26 Seventh, Frost also failed to disclose to investors in the Funds the existence of SDC  
27 and that it was also charging fees to the portfolio companies. Frost created SDC in 2014,  
28 in part, to provide employment to one of Frost’s long-term former employees, Anthony

1 Howcroft, who needed to be associated with SDC for immigration purposes. (AF 49).  
2 Although FDC had generally been charging the portfolio companies for sales and  
3 marketing, beginning in approximately April 2014, SDC began charging certain portfolio  
4 companies \$5,100 per month through FDC for marketing services, in addition to the  
5 marketing fees being charged by FDC. (Searles Decl. ¶ 100; ECF No. 44-9 at 145-146,  
6 277; AF 49, 51). Frost admits he never disclosed to the Funds’ investors the existence of  
7 SDC or its fees. (AF 52). As discussed below, this failure alone demonstrates recklessness,  
8 at a minimum.

9 Finally, as Frost admits, the Funds’ quarterly reports distributed to investors did not  
10 disclose the Incubator fees paid by the portfolio companies or their amounts. (AF 63).

## 11 2. Materiality

12 Frost’s statements and omissions of fact were material. A statement or omitted fact  
13 is material if there is a “substantial likelihood” that a reasonable investor would have  
14 considered the untrue statements and omitted facts important in his or her decision making,  
15 and disclosure of the omitted facts would have “significantly altered the ‘total mix’ of  
16 information made available.” *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting  
17 *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449, (1976)). “[T]he ‘reasonable  
18 investor’ test is an objective standard,” and thus the reactions of the actual investors are  
19 not dispositive. *SEC v. Sztrom*, 538 F. Supp. 3d 1050, 1061 (S.D. Cal. 2021).

20 The Court finds a reasonable investor would have wanted to know before investing  
21 in the Seed Fund and Fund II that a good portion of the investor’s investment would be  
22 used to pay monthly Incubator fees to FDC and, by extension, a portion of Frost’s salary  
23 and would have wanted to know the extent of such fees. A reasonable investor, before  
24 deciding to invest in Fund II, would also have wanted to know that a portion of the  
25 investor’s investment would, in fact, be used to pay an average monthly Incubator fee of  
26 \$25,000 to \$40,000 month to FDC and, by extension, a portion of Frost’s salary, instead of  
27 being told by the governing documents that the fees “may” be imposed. A reasonable  
28 investor also would have wanted to know that inherent conflicts of interest existed due to

1 Frost’s decision-making authority over Fund II’s investments through FMC and his self-  
2 interest in FDC and that an Advisory Committee would not be used to safeguard against  
3 such conflicts. Additionally, a reasonable investor would have wanted to know that no  
4 independent body would be put in place to safeguard Fund investments by overseeing and  
5 addressing any such conflicts and that, in the case of Fund II, the committee established  
6 would not be used to consider any conflicts. *See SEC v. Criterion Wealth Mgmt. Servs.,*  
7 *Inc.*, 599 F. Supp. 3d 932, 952 (C D. Cal. 2022) (“actual and potential conflicts of interests  
8 are indisputably material facts” that section 206 requires an investment advisor to disclose  
9 to investors and prospective investors (internal quotations, citations, and alterations  
10 omitted)).

11 In sum, on this record, the Court is persuaded that a reasonable investor, even one  
12 that is sophisticated, would have considered Frost’s untrue statements and omissions  
13 regarding the nature and extent of Incubator fees being charged by FDC and SDC, as well  
14 as Frost’s conflicts of interests and self-dealing, to be material. Frost’s failure to disclose  
15 these material facts, among others, was therefore fraudulent, manipulative, and deceptive  
16 within the meaning of the Act. *See Cap. Gains Rsch. Bureau*, 375 U.S. at 200.

### 17 3. Scienter

18 The Ninth Circuit has held for purposes of the federal securities laws generally that  
19 a finding of recklessness is sufficient to support a finding that a defendant acted with  
20 scienter. *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d 1046, 1053 (9th Cir. 2014) (citing  
21 *Hollinger v. Titan Cap. Corp.*, 914 F.2d 1564, 1568–69 (9th Cir. 1990) (en banc)); *see also*  
22 *Ponce v. SEC*, 345 F.3d 722 (9th Cir. 2003) (“In the Ninth Circuit, scienter may be  
23 established by demonstrating that the defendant acted recklessly.”). Similarly, “scienter”  
24 under the Advisory Act also refers to “knowing or reckless conduct.” *Vernazza v. SEC*,  
25 327 F.3d 851, 860 (9th Cir. 2003) (applying the same standard for scienter under the  
26 Advisory Act as under both section 10(b) of the Exchange Act of 1934 and section 17(a)(1)  
27 of the Securities Act of 1933). “Whether a defendant acted with scienter is a ‘subjective  
28 inquiry,’ which ultimately ‘turns on the defendant’s actual state of mind.’” *Husain*, 70

1 F.4th at 1185 (citing *Gebhart v. SEC*, 595 F.3d 1034, 1042 (9th Cir. 2010)). However,  
2 “[p]roof of scienter is often based on inference from circumstantial evidence.” *SEC v.*  
3 *Burns*, 816 F.2d 471, 474 (9th Cir. 1987); *see also Gebhart*, 595 F.3d at 1041 (“Scienter  
4 can be established by direct or circumstantial evidence.” (citation omitted)).

5 Based on the Court’s review of the record, the Court finds that Frost acted with  
6 recklessness when he: made the untrue and misleading representations to investors of the  
7 Seed Fund and International Seed Fund that no Incubator fees would be paid with investor  
8 funds; falsely represented to investors of Fund II only that Incubator fees “may” be paid  
9 and would be based on the portfolio companies’ shared costs and at reasonable market  
10 rates; utterly failed to disclose to investors the existence of SDC and that a portion of  
11 Funds’ investments would be used to pay SDC’s fees; failed to fully and accurately disclose  
12 to investors in all Funds the extent of his conflicts of interest and motivations for creating  
13 portfolio companies; and failed to disclose to investors in all Funds that no safeguards  
14 would actually be implemented to protect their investment or safeguard Frost’s and FMC’s  
15 investment decisions.

16 As to the Seed Fund, Frost knew or should have known at the time the governing  
17 documents were disclosed to investors that they represented an Advisory Committee would  
18 be established to review conflicts of interest between FMC, any members of FMC, and the  
19 Seed Fund. (AF 24-25, 29; ECF No. 162-8 at 12-13). As to Fund II, which was established  
20 in approximately 2013, Frost reviewed and approved the Fund II Agreement before it was  
21 disseminated to investors. (Searles Decl. ¶ 101; ECF No. 44-9 at 224-225). By then, Frost,  
22 through FDC, had already started portfolio companies and was collecting Incubator fees  
23 and therefore knew or should have known that FDC was, in fact, charging Incubator fees  
24 to portfolio companies generally from the moment a portfolio company was formed,  
25 contrary to the optional language used in Fund II’s governing documents. *See* (AF 67).  
26 As to Fund III, Frost’s communications with portfolio companies regarding the fees being  
27 fixed were contemporaneous with, and directly contradicted, the representations being  
28 made to investors that the fees were negotiable and apportioned. As such, Frost knew or

1 should have known that the statement in Fund III’s governing documents were not true,  
2 were deceptive, and were misleading. Indeed, Frost admits that the fees initially collected  
3 by FDC from portfolio companies were fixed at a flat rate per month, (AF 68), and were  
4 not, in fact, based on the portfolio company’s shares of the cost of resources provided by  
5 FDC for shared facilities, shared personnel, and other shared resources, (AF 41). As to  
6 SDC, the evidence in the record demonstrates FDC was already charging portfolio  
7 companies for marketing services and that Frost’s primary motive for creating SDC and  
8 not disclosing it was to address Howcroft’s immigration issues. From, among other  
9 evidence in the record, Frost’s review of the government documents for the various Frost  
10 entities, as well as his statements regarding wearing different metaphorical hats, Frost was  
11 also aware of his conflicts of interest due to his management of FMC, FDC, the various  
12 Frost entities, and the Funds and his compensation arrangements with these entities, yet  
13 the extent of these conflicts was either not disclosed to the Funds’ investors or was not  
14 sufficiently disclosed. Nor did Frost establish an independent body to advise the Funds  
15 regarding his conflicts of interest. Any one of the aforementioned examples is sufficient  
16 to create an inference of recklessness. *See Vernazza*, 327 F.3d at 860. Taken together, the  
17 Court has no reservation in finding Frost acted with recklessness.

18 4. Lack of Good Faith

19 a. *Advice of Counsel*

20 Frost’s suggestion in his Opposition and declaration in support that he relied on the  
21 advice-of-counsel in failing to make the requisite disclosures to investors is unavailing.  
22 *See* (Frost Decl. ¶ 34 (“We engaged a well-regarded law firm in the venture capital space,  
23 Cooley LLP (“Cooley”) to advise the Fund regarding, and to draft, disclosures and  
24 agreements.”); Opp. at 11 (“Frost engaged a respected law firm, Cooley . . . to ensure that  
25 all legal disclosures to investors were complete and accurate.”)). As Judge Staton found,  
26 Frost invoked the attorney-client privilege during his deposition in this case when  
27 questioned about, among other topics, what, if any, information he and others provided to  
28 and received from Cooley concerning making proper disclosures in the governing

1 documents; charging portfolio companies Incubator fees; setting the rate of such fees; and  
2 assessing management fees. (Supp. Searles Decl. ¶ 3; *id.* at 8-13). Consequently, Judge  
3 Staton granted the SEC’s motion *in limine* to exclude evidence or argument by Frost  
4 regarding the advice or presence of counsel. (ECF No. 148). In particular, Judge Staton  
5 explained that Frost is asserting he “should be allowed to present evidence that  
6 demonstrates [he] engaged in a ‘good faith effort to provide adequate disclosures to  
7 investors through consultation with counsel,’ and [he] also seek[s] ‘to offer evidence  
8 concerning the participation of attorneys in reviewing and preparing the documents at  
9 issue.’” (*Id.* at 1-2). Judge Staton found Frost was essentially asserting a “back door”  
10 advice of or presence of counsel defense and declined to permit such evidence.  
11 Specifically, she held that, given Frost’s repeated refusal to disclose the content of  
12 communications with Cooley regarding the disclosures at issue, if Frost were allowed to  
13 suggest that Cooley had explicitly or implicitly “blessed” the offerings and level of  
14 disclosures without Frost waiving the attorney-client privilege, it would give Frost all the  
15 essential benefits of an advice of counsel defense without having to bear the burden of  
16 proving any of the elements of the defense. Judge Staton thus precluded Frost from  
17 offering any evidence or argument at trial regarding the advice, involvement, or presence  
18 of counsel. (*Id.* at 8); *see also SEC v. Lek Sec. Corp.*, No. 17CV1789 (DLC), 2019 WL  
19 5703944, at \*4 (S.D.N.Y. Nov. 5, 2019) (“The intimation that counsel has blessed a  
20 transaction or practice without waiver of the attorney-client privilege ‘would give the  
21 defendant all of the essential benefits of an advice of counsel defense without having to  
22 bear the burden of proving any of the elements of the defense.’” (quoting *SEC v. Tourre*,  
23 950 F. Supp. 2d 666, 684 (S.D.N.Y. 2013))).

24       The circumstances have not changed for purposes of the present Motion. Nor is  
25 reconsideration of Judge Staton’s order warranted. Accordingly, Frost has not shown his  
26 purported reliance on any advice from Cooley provides a good faith basis for him making  
27 the untrue and misleading statements to investors or otherwise engaging in his fraudulent,  
28 deceptive, or manipulative acts.

1                   b.     *Reliance on Auditors*

2             Frost also claims that, in making disclosures, he relied in good faith on the Seed  
3 Fund, International Seed Fund, and Fund II’s outside auditor, Marcum, LLP (“Marcum”),  
4 which Frost claims opined the amount of FDC’s Incubator fees did not need to be disclosed  
5 in those Funds’ financial statements. (Opp. at 11, 13, 29); *see also* (Frost Decl. ¶¶ 34-36;  
6 Supp. Searles Decl. at 129). The SEC responds that whether the Incubator fees should  
7 have been disclosed by the Funds in their financial statements is irrelevant to whether Frost  
8 should have disclosed the existence of and amount of FDC’s Incubator fees to investors.  
9 (Reply at 11).

10            The Court agrees that whether Marcum opined favorably from an accounting  
11 perspective on the Funds’ nondisclosure of the indirect payment of Incubator fees *in their*  
12 *financial statements* is not determinative of whether Frost’s nondisclosures to investors in  
13 the Funds violated the Act. Moreover, Frost cannot establish good faith reliance on  
14 Marcum’s opinions regarding nondisclosure of Incubator fees in the Funds’ financial  
15 statements if he knew all material information regarding the Fund’s financial transactions  
16 during the relevant period was not properly disclosed to Marcum. *SEC v. Goldfield Deep*  
17 *Mines Co. of Nev.*, 758 F.2d 459, 467 (9th Cir. 1985) (“If a company officer knows that  
18 the financial statements are false or misleading and yet proceeds to file them, the  
19 willingness of an accountant to give an unqualified opinion with respect to them does not  
20 negate the existence of the requisite intent or establish good faith reliance.” (citation  
21 omitted)).

22            Here, there is sufficient evidence in the record for the Court to conclude that Frost  
23 and others with Frost’s knowledge did not disclose all material information regarding the  
24 Incubator fees to Marcum, notwithstanding Frost’s assurances to Marcum of full and fair  
25 disclosure. *See, e.g.*, (Searles Decl. ¶¶ 17-18, ECF No. 44-6 at 26, 34 (2013  
26 correspondence from Frost on behalf of the International Seed Fund to Marcum assuring  
27 Marcum that all relevant and material information had been disclosed to Marcum,  
28 including “related party transactions or other transactions with affiliates”). First, Marcum

1 senior manager, Kellen McConnell, testified in his deposition that Marcum’s initial  
2 nondisclosure opinion, upon which Frost relies, was limited to its narrow scope of work on  
3 the Funds’ financial statements and did not include a general opinion of whether Frost or  
4 FMC had made proper disclosures under the Act to investors regarding the amount of  
5 Incubator fees being paid by portfolio companies. *See* (Schneider Decl. ¶ 12; ECF No.  
6 162-88 at 4). McConnell further testified that, before Marcum issued its initial opinion,  
7 Frost did not disclose to Marcum FDC’s general policy and methodology of when it would  
8 begin charging portfolio companies Incubator fees, the amount of fees FDC would charge,  
9 and how long such fees would be charged. (*Id.*).

10 Second, although Guerry now asserts in his declaration in support of the Opposition  
11 that he “completely and accurately disclosed the inner workings of the Incubator Model to  
12 Marcum, including information about the Incubator fees,” *see* (Guerry Decl. ¶ 29), Guerry  
13 does not identify in his declaration what specific information he provided to Marcum  
14 before 2017 or when such information was provided. Guerry’s assertion also appears to  
15 be inconsistent with his 2017 testimony in post Arbitration proceedings that, before  
16 approximately 2017, neither he nor anyone from FDC had ever given Marcum any  
17 information about the fees charged by FDC to the portfolio companies. (Supp. Searles  
18 Decl. at 124). Further, even after Marcum was notified in 2017 that investor Hollencrest  
19 was challenging Frost’s failure to disclose FDC’s imposition of Incubator fees on portfolio  
20 companies, Guerry testified that he and Frost deflected Marcum’s requests to receive a  
21 schedule of fees FDC had received since inception from portfolio companies by year and  
22 portfolio company, the methodology for setting such fees, and documentation  
23 demonstrating that such fees were set at “market-rate.” *See* (ECF Nos. 162-105 at 2; 162-  
24 106). Guerry also testified that, when he finally did transmit to Marcum summaries of the  
25 fees via a February 11, 2017, email, it was the first time the requested schedule of fees had  
26 been provided to Marcum and the first time that FDC had given Marcum any specific  
27 information about the fees charged by FDC to the portfolio companies. (Supp. Searles  
28 Decl. at 20-21, 33-97, 124).

1 Finally, although Frost now suggests that he was not involved in Guerry's  
2 nondisclosure decisions because his focus was "on building companies, while delegating  
3 financial matters to Guerry," (Opp. at 11), Guerry testified the reason he pushed back in a  
4 2017 letter he wrote to Marcum regarding a Marcum executive's "strong opinion" that  
5 information regarding the fees being paid by portfolio companies to FDC should be  
6 disclosed in the Funds' financials was because, "[a]t the time, Mr. Frost didn't want to  
7 disclose them, so I was working on a solution that I am trying to see if that would be  
8 acceptable or not." (Supp. Searles Decl. at 22). Guerry's testimony is consistent with  
9 Frost's deposition testimony stating it was Frost's general position that the nature, extent,  
10 and methodology behind the Incubator fees should not be disclosed to investors, *see* (ECF  
11 No. 44-9 at 86-89, 228, 230), though Frost asserted he did not recall the disagreement  
12 between Guerry and Marcum on whether the Incubator fees should be disclosed, (ECF No.  
13 44-9 at 92). Accordingly, the Court rejects Frost's reliance on the initial nondisclosure  
14 opinion of Marcum to show good faith in failing to sufficiently disclose the Incubator fees  
15 in documents provided to Funds' investors.

16 Based on the foregoing, the Court finds that the first factor weighs in favor of issuing  
17 an injunction.<sup>27</sup>

18 **B. Second Factor: The Isolated or Recurrent Nature of the Infraction**

19 Under the second factor, the question for the court's consideration is whether the  
20 "violative acts were part of an ongoing pattern of conduct rather than isolated incidents."  
21 *SEC v. Jasper*, 883 F. Supp. 2d 915, 929 (N.D. Cal. 2010). "Decisions on this factor usually  
22 turn on the length of the scheme to defraud, the number of insider transactions, and the  
23 number of companies the transactions involved." *SEC v. Sabrdaran*, 252 F. Supp. 3d 866,  
24 908 (N.D. Cal. 2017).

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25  
26 <sup>27</sup> Frost also argues that Frost's loan of nearly five million to FDC between February 2016  
27 and January 2019 to keep it afloat demonstrates his good faith. *See* (Opp. at 30). However,  
28 as the SEC points out, the terms of those loans only created additional, undisclosed  
conflicts, as they provided Frost with preferential treatment ahead of the Fund's investors.  
(Reply at 17 (citing ECF No. 44-3 at 97-109; Supp. Searles Decl. at 99-120)).

1           The SEC contends that Frost’s fraudulent course of conduct continued for years,  
2 from 2012 through 2016, and involved multiple instances of fraudulent conduct. (Mot. at  
3 22). Frost responds that his conduct was an “isolated occurrence occasioned by Frost  
4 venturing for the first and only time into managing a fund in combination with an  
5 [I]ncubator.” (Opp. at 22). The record demonstrates, however, that Frost’s violations were  
6 part of an ongoing pattern of conduct and not an isolated incident as he claims. Frost’s  
7 violations of the Act spanned from 2012 to at least 2016, involved fraudulent, deceptive,  
8 and manipulative conduct occurring throughout that period, and were not mere technical  
9 violations of the Act. As such, the nature of Frost’s violative acts weighs in favor of an  
10 injunction. *See SEC v. Analytica Bio-Energy Corp.*, 317 F. Supp. 3d 574, 579 (D.D.C.  
11 2018) (issuing injunction where the defendant filed false statements with the SEC in “18  
12 separate reports over the course of more than a year”); *SEC v. Alexander*, 115 F. Supp. 3d  
13 1071, 1086 (N.D. Cal. 2015) (finding “a scheme that spanned nearly two years and  
14 impacted dozens of investors” weighed in favor of entering an injunction); *SEC v. Hansen*,  
15 No. 13-CV-1403 (VSB), 2017 WL 1298022, at \*7 (S.D.N.Y. Mar. 31, 2017) (“[B]ecause  
16 the scheme lasted for five years, it can hardly be described as an ‘isolated occurrence.’”),  
17 *aff’d*, 712 F. App’x 99 (2d Cir. 2018); *SEC v. Loren*, 76 F.3d 458, 461 (2d Cir. 1996)  
18 (“When the violation has been founded on systematic wrongdoing, rather than an isolated  
19 occurrence, a court should be more willing to enjoin future misconduct.” (citation and  
20 alterations omitted)).

21           The Court is mindful that roughly nine years have elapsed since the end of the period  
22 of the relevant violations of the Advisory Act were alleged to have occurred. Such passage  
23 of time generally weighs heavily against imposing an injunction. *See, e.g., SEC v. Jones*,  
24 476 F. Supp. 2d 374, 384 (S.D.N.Y. 2007) (noting that “several years ha[d] passed since  
25 [d]efendants’ alleged misconduct apparently without incident” and stating “[t]his fact  
26 further undercuts the Commission’s assertion that [d]efendants pose a continuing risk to  
27 the public”); *SEC v. Dibella*, No. 04 Civ. 1342 (EBB), 2008 WL 6965807, at \*13 (D. Conn.  
28 Mar. 13, 2008) (“[T]he passage of nearly 10 years without another violation weighs heavily

1 against an injunction.”), *aff’d*, 587 F.3d 553 (2d Cir. 2009). However, the passage of time  
2 “is just one factor among several to be weighed” by this Court. *Lorin*, 76 F.3d at 461  
3 (citing *SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044, 1048 (2d Cir. 1976), *cert.*  
4 *denied*, 434 U.S. 834 (1977)). The Court notes that Frost spent much of the time litigating  
5 the Arbitration proceeding and this case. “But just because defendants may refrain from  
6 illegal activity during litigation does not mean they are unlikely to violate the securities  
7 laws again.” *SEC v. Murphy*, 50 F.4th 832, 851 (9th Cir. 2022) (“*Murphy IP*”). Indeed, as  
8 discussed below, even after admitting negligence, Frost has continued to advance  
9 arguments in opposition to the Motion that undermine the factual basis for his admission  
10 of liability. Thus, notwithstanding the passage of time, the Court finds this factor weighs  
11 slightly in favor of an injunction. *SEC v. Mattessich*, No. 18 Civ. 5884 (KPF), 2022 WL  
12 16948236, at \*8 (S.D.N.Y. Nov. 15, 2022) (enjoining conduct even though nine years had  
13 elapsed since the defendant’s violations had occurred); *SEC v. Rashid*, No. 17-CV-8223  
14 (PKC), 2020 WL 5658665, at \*26 (S.D.N.Y. Sept. 23, 2020) (finding the defendant’s  
15 violative conduct, which was repeated over a period of years and was unaltered even after  
16 discovery of his false statements, warranted imposition of an injunction), *rev’d on other*  
17 *grounds*, 96 F.4th 233 (2d Cir. 2024).

### 18 **C. Third Factor: Frost’s Recognition of the Wrongful Nature of his Conduct**

19 Third, the Court considers the degree to which Frost has recognized the wrongful  
20 nature of his conduct. *See Fehn*, 97 F.3d at 1295. A person’s “lack of remorse” can be  
21 “apparent in” the person’s “continued insistence on the validity of his” conduct that has  
22 been found to be a violation of the Advisers Act. *See id.* at 1296; *cf. First City Fin. Corp.*,  
23 890 F.2d at 1229 (explaining that securities defendants are “not to be punished because  
24 they vigorously contest the government’s accusations”).

25 Frost maintains his violations were due to his ignorance of the requirements of being  
26 an investment advisor, as well as his playing a passive role in making disclosures. *See*  
27 (Frost Decl. ¶ 111 (“In retrospect, I would certainly do things differently, and I recognize  
28 that I did not understand the full scope of what it meant to serve an investment adviser.”));

1 *id.* ¶ 112 (stating he should have “(i) taken a more active role in the process of preparing  
2 the disclosures to investors; (ii) obtained a third party analysis regarding the amount of the  
3 Incubator fees to ensure the fees did not exceed a reasonable market rate; (iii) install  
4 processes to separate my personal and business expenses; and (iv) create systems to  
5 manage conflicts between the interests of Funds, the Incubator, and FMC”). While the  
6 Court credits Frost for admitting he committed negligent violations of the Act, Frost  
7 acknowledging that he should have “taken a more active role” in preparing the disclosures  
8 to investors is not the same as acknowledging which of his disclosures were false,  
9 misleading, or deceptive.

10 Further, based on Frost’s declaration in support of his Opposition and the broader  
11 record, the Court does not conclude that Frost has meaningfully recognized the wrongful  
12 nature of his conduct. Instead, Frost’s submissions to the Court reflect an effort to avoid  
13 and deflect responsibility and his continued minimization of his conduct. At times, he  
14 directly repudiates the very facts he agreed in the Admitted Facts are true. For example,  
15 AF 25 states, in pertinent part, that in the event of a tie investment decision, the decision  
16 would be made by Frost as manager of FMC, and “. . . all members of the investment  
17 committee would be required to vote in accordance with the determination of the fund  
18 manager, i.e., Frost.” However, in his Opposition, Frost argues, “[c]ontrary to the SEC’s  
19 assertion that ‘all members of the investment committee would be required to vote in  
20 accordance with the determination of . . . Frost,’ (Mot. at 5) many ideas, including Frost’s  
21 were rejected.” (Opp. at 14). And, throughout his opposition, Frost continues to dispute  
22 the impropriety of his disclosures to investors regarding FDC’s charging of monthly  
23 Incubator fees to its portfolio companies.

24 Further, Frost’s Opposition and Declaration still deflect blame for his conduct to  
25 Guerry, Marcum, and Cooley. *See* (Frost Decl. ¶ 33 (“I focused on running the Incubator  
26 and developing ideas for companies, while delegating responsibility for the finances to  
27 William Guerry, who served as the CFO for the Incubator, FMC, and other entities in the  
28

1 enterprise”); *id.* ¶ 34 (“We engaged a well-regarded law firm in the venture capital  
2 space . . . to advise the Fund regarding, and to draft, disclosures and agreements.”)).

3 On this record, the Court thus finds Frost has failed to adequately recognize the  
4 wrongfulness of his conduct. *See* (Opp. at 27–28, 29–30); *see also SEC v. Thomas*, No.  
5 2:19-cv-01515-APG-VCF, 2021 WL 5826279, at \*11 (D. Nev. Aug. 24, 2021) (finding a  
6 permanent injunction was warranted despite the defendant’s declaration that he would not  
7 sell securities again and that he did not knowingly violate the law because his statements  
8 failed to “adequately recognize the wrongful nature of his conduct”); *cf. Husain*, 70 F.4th  
9 at 1184–85 (defendant admitted in a declaration that specific SEC filings contained  
10 material misrepresentations and omissions). This factor therefore weighs in favor of an  
11 injunction.

#### 12 **D. Fourth Factor: Likelihood of Future Violations**

13 Under the fourth *Murphy* factor, courts consider “the likelihood, because of a  
14 defendant’s professional occupation, that future violations might occur.” *Murphy I*, 626  
15 F.2d at 655. Here the parties disagree whether Frost’s current work increases the risk of  
16 future violations. The SEC argues that Frost has “expressed interest in engaging in  
17 securities offerings in the future,” so Frost poses a risk of future violations. Frost, however,  
18 represents in his declaration, “[g]oing forward, I only intend to run Geminos [his present  
19 company] and may serve on the board of other companies. I hope to build a profitable  
20 company for the Geminos investors.” (Frost Decl. ¶ 114). “I have no interest in and will  
21 never again act as an investment adviser.”<sup>28</sup> (*Id.* ¶ 115). Yet he states, “[w]hile I do not  
22 intend to ever again serve as an investment adviser (and thus do not foresee any potential  
23 applicability of the Investment Advisers Act moving forward), I intend to comply with  
24 whatever state and federal securities laws are applicable to my current and future business  
25 ventures and will do the diligence required to ensure I am in compliance with these laws.”  
26 (*Id.* ¶ 117)

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27  
28 <sup>28</sup> The Court notes that, to date, no updates have been filed by either party notifying the  
Court whether the nature of Frost’s business ventures have changed.

1 Frost’s representations leave open the possibility of him once again becoming  
2 involved in some capacity in the securities industry, and his continued goal of pursuing  
3 what he describes as “business ventures” could put him in a position of having to solicit  
4 investors and thereby increase the likelihood of future violations of federal securities laws.  
5 *Fehn*, 97 F.3d at 1296 (upholding injunction where defendant engaged in single securities  
6 act violation, did not intend to violate the securities law, and gave “sincere assurances of  
7 an intent to refrain” from future violations, but whose professional occupation “tend[ed] to  
8 suggest a risk of future violations”); *SEC v. Cap. Cove Bancorp*, No. 8:15-cv-980-JLS-  
9 JCx, 2018 WL 11370008, at \*3 (C.D. Cal. Jan. 17, 2018) (defendant’s occupation helps to  
10 “point to [a] strong likelihood of future violations”); *Hansen*, 2017 WL 1298022, at \*7  
11 (“While Hansen does not appear to be in a position to participate in future violations of the  
12 securities laws, due in part to his current period of incarceration and other measures put in  
13 place through supervised release or the SEC, it is not outside the realm of possibility.”).  
14 The Court thus finds this factor weighs in favor of imposing a permanent injunction.

15 **E. Fifth Factor: Sincerity of Assurances Against Future Violations**

16 The fifth Murphy factor considers a defendant’s contrition. The Ninth Circuit has  
17 held that “sincere assurances of an intent to refrain from aiding and abetting future  
18 violations are insufficient, without more, to militate against an injunction.” *Fehn*, 97 F.3d  
19 at 1296; *see also Murphy I*, 626 F.2d at 656 (“The fact that [defendant] violated the  
20 requirements once when he did not intend to do so is sufficient to justify the conclusion  
21 that he might do so again, even if the court believed he was sincere in his protestations to  
22 the contrary.”).

23 Here, Frost has declared that he “never again will serve as an investment advisor or  
24 work for a complicated fund structure.” (Frost Decl. ¶ 114). And as of December 31,  
25 2018, FMC has not renewed its status as an exempt reporting adviser. (Ans. ¶ 12).  
26 However, as discussed previously, Frost’s deflection of responsibility and failure to  
27 recognize the extent of his fraudulent, manipulative, and deceptive behavior cuts against  
28 his assurances of future violations. *See e.g., SEC v. RMR Asset Mgmt. Co.*, 553 F. Supp.

1 3d 820, 827 (S.D. Cal. 2021) (“[T]he sincerity of their assurances, however, are weakened  
2 in part by their failure to completely recognize the wrongfulness of their past conduct.”);  
3 *Sabrdaran*, 252 F. Supp. 3d at 909 (“Promising to stop doing wrong while denying any  
4 wrongdoing is the wrong way to establish that wrongdoing will not reoccur.” (quoting  
5 *SEC v. Ginsburg*, 362 F.3d 1292, 1305 (11th Cir. 2004)); *Murphy I*, 626 F.2d at 656 (“The  
6 fact that he violated the requirements once when he [claims] he did not intend to do so is  
7 sufficient to justify the conclusion that he might do so again, even if the court believed he  
8 was sincere in his protestations to the contrary.”); *Murphy II*, 50 F.4th at 852 (holding the  
9 district court “acted within its discretion by imposing injunctive relief” where defendants’  
10 assurances were “contradicted by their current involvement in the securities industry and  
11 apparent failure to appreciate the wrongfulness of their past conduct”); *SEC v. Koracorp*  
12 *Indus. Inc.*, 575 F.2d 692, 698 (9th Cir. 1978) (“Promises of reformation and acts of  
13 contrition” are not “conclusive or even necessarily persuasive, especially if no evidence of  
14 remorse surfaces until the violator is caught”). Because Frost does not appear to have  
15 recognized the extent of the unlawful nature of his conduct, this factor weighs in favor of  
16 an injunction.<sup>29</sup>

#### 17 **F. Collateral Consequences**

18 Frost argues that the negative collateral consequences an injunction would have on  
19 Frost’s livelihood weigh against an injunction. Specifically, Frost claims that, because an  
20 injunction would have the effect of “effectively barring him from acting as an  
21 entrepreneurial CEO in the same lawful manner as he has done successfully for decades,  
22 and the events involving the Frost entities have already had a detrimental impact on Frost  
23

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24 <sup>29</sup> By making this finding, the Court does not hold Frost’s decision to defend against this  
25 suit or assertion of legal defenses against him. Further, the Court credits Frost’s decision  
26 to admit negligence liability on Claim Two. Nevertheless, Frost’s declaration and other  
27 filings in opposition to the Motion reflect that he continues to deflect blame to other  
28 individuals and minimize his conduct, notwithstanding his active role in the decision  
making, representations, and conduct that form the basis of the Court’s recklessness  
finding.

1 personally, financially, and professionally, these consequences strongly support denying  
2 an injunction.” (Opp. at 31). The SEC responds that Frost overstates the collateral  
3 consequences of an injunction because a “Bad Actor” designation, if issued under  
4 paragraphs (d) and (e) of Rule 506 of the Securities Act, would only disqualify Frost from  
5 availing himself of the exemptions under Rule 506(b) and (c) for a period of five years,  
6 would not prevent Frost from raising funds through a non-public offering or through a  
7 registered offering, and the SEC could elect to waive bad actor designation altogether.  
8 (Reply at 19-20).

9 The Court agrees with the SEC. Contrary to Frost’s assertion, the SEC is not seeking  
10 an officer and director bar against Frost, so he would remain free to act as a CEO for his  
11 current company and whatever other company he chooses. (Reply at 7). In particular,  
12 Section 5 of the Securities Act requires the registration of all securities offerings, subject  
13 to certain exemptions and safe harbors. 15 U.S.C. §§ 77e(a), (c). Rule 506(d) provides, in  
14 relevant part, that no exemption from registration shall be available for a sale of securities  
15 if the issuer, or any director, executive officer, or other officer participating in the offering  
16 is “subject to any order, judgment, or decree of any court of competent jurisdiction, entered  
17 within five years before such sale, that at the time of such sale, restrains or enjoins such  
18 person from engaging or continuing to engage in any conduct or practice ... [i]n connection  
19 with the purchase or sale of any security ...or...[a]rising out of the conduct of the business  
20 of [an] . . . investment adviser.” 17 C.F.R. § 230.506(d)(1)(ii)(A), (C). Thus, a permanent  
21 injunction against Frost could result in him being deemed a “bad actor” who could not  
22 serve as a “covered person” with an entity that raises capital under Rule 506 for a five-year  
23 period.

24 However, as the SEC points out, the SEC, under certain circumstances, is authorized  
25 to waive Frost’s bad actor disqualification if it determines that Frost has shown “good  
26 cause” that it is not necessary. *See* 17 C.F.R. § 230.506(d)(2)(ii). The SEC administers a  
27 comprehensive process for an applicant to seek a waiver from disqualification under Rule  
28 506(d)(2)(ii), including requiring the party seeking a waiver to submit a written application

1 to the SEC for consideration and analysis. *See* Statement on Waivers of Disqualification  
2 under Regulation A and Rules 505 and 506 of Regulation D (Mar. 13, 2015) (available at  
3 <https://www.sec.gov/divisions/corpfin/guidance/disqualification-waivers.shtml>).

4 Frost offers no justification for why the Court should wade into the bad actor  
5 question when the SEC has a waiver process. Indeed, Frost points to no instance in which  
6 a court has refused to issue an injunction to avoid triggering the Regulation D bad actor  
7 provision. Instead, courts have declined to issue an injunction where it would have a  
8 detrimental impact on an individual’s ability to earn a living. For example, in *SEC v.*  
9 *Ambassador Advisors, LLC*, No. 5:20-CV-02274-JMG, 2022 WL 4097327, at \*5 (E.D. Pa.  
10 Sept. 7, 2022), the court declined to enter an injunction as it would have resulted in an  
11 administrative associational bar that would have prevented the defendants from continuing  
12 to earn a living in their chosen profession. *See also SEC v. Westport Cap. Mkts., LLC*, 547  
13 F. Supp. 3d 157, 168 (D. Conn. 2021) (district court denied injunctive relief, in part,  
14 because it “would very likely end [the defendant’s] career.”); *SEC v. McDermott*, No. 189-  
15 4229-KSM, 2022 WL 16533556, at \*7 (E. D. Pa. Oct. 28, 2022) (court declined to enter  
16 an injunction, as it would be career ending for the defendant, and would negatively affect  
17 defendant’s 314 advisory clients, who would be forced to retain a new adviser or manage  
18 their own accounts). Here, Frost has not shown that such consequence would flow from  
19 Frost being designated a “bad actor” under Rule 506(d).

20 Frost also cites *Sabrdaran*, 252 F. Supp. 3d at 911, as an example where the court  
21 declined to issue an injunction despite finding the defendants acted with scienter.  
22 However, a key reason the court refrained from enjoining the defendants was its  
23 “imposition of a permanent director and officer bar as to [defendant] based on the [c]ourt’s  
24 finding that he is unfit for office in a public company. It is in part because of this bar that  
25 the further remedy of injunction is not necessary.” *Id.* No such facts exist here.

26 Finally, the Court notes that by imposing the permanent injunction, the Court is not  
27 seeking to punish Frost for his conduct; the Court is simply imposing a prophylactic  
28 measure to protect the investing public. Throughout this Order, the Court has discussed a

1 non-exhaustive list of examples of Frost’s fraudulent, manipulative, and deceptive conduct  
2 and has carefully weighed the required *Murphy* factors to determine whether there is a  
3 “reasonable likelihood of future violations of the securities laws.” Although the Court  
4 acknowledges the amount of time that has elapsed in this case since the relevant violation  
5 period, the Court nevertheless concludes, on balance, that the *Murphy* factors still weigh  
6 in favor of a permanent injunction. The Court has assessed, as it is required to do, the  
7 seriousness, extent, and duration of Frost’s violative conduct, his minimal level of  
8 contrition reflected in the record, and the likelihood of him repeating similar conduct, given  
9 that he expresses a desire to be involved with business ventures in the future—the very  
10 conduct that resulted in his violation of the Act. Based on that assessment, the Court finds  
11 that an injunction is appropriate and is not punitive.

12 **V. CONCLUSION**

13 For the foregoing reasons, the Court GRANTS the SEC’s Motion to permanently  
14 restrain and enjoin Frost from any violation of Section 206(4) of the Investment Advisers  
15 Act of 1940, 15 U.S.C. § 80b-6(4), and Rule 206(4)-8 adopted thereunder, 17 C.F.R.  
16 § 275.206(4)-8. Specifically, the Court enjoins Frost, while acting as an investment adviser  
17 to a pooled investment vehicle, from (i) making any untrue statement of material fact or  
18 omitting to state a material fact necessary to make the statements made, in light of the  
19 circumstances under which they were made, not misleading to any investor or prospective  
20 investor in the pooled investment vehicle; or (ii) otherwise engaging in any act, practice,  
21 or course of business that is fraudulent, deceptive, or manipulative with respect to any  
22 investor or prospective investor in the pooled investment vehicle.

23 **IT IS SO ORDERED.**

24  
25 DATED: September 12, 2025

26   
27 HON. SHERILYN PEACE GARNETT  
28 UNITED STATES DISTRICT JUDGE