UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMISSION, *Plaintiff,* v. LFS FUNDING LIMITED PARTNERSHIP, a private Wyoming Limited Partnership; STEPHEN MICHAEL THOMPSON; STEVEN ROBERT COMISAR; DALE JAY ENGELHARDT; and, ROSS GREGORY ERSKINE, *Defendants,* and BROOKDALE CONSULTING LLC, a private California Limited Liability Company; EXECUTIVE PERFORMANCE GROUP, INC., a private California corporation; MERIDIAN POINT, LLC, a private Nevada Limited Liability Company; and PERSONAL GROUP, LLC, a private Nevada Limited Liability Company, *Relief Defendants.*	Case No. 2:21-cv-04211-HDV-MARx **ORDER GRANTING PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT [98]**

I. INTRODUCTION

Plaintiff Securities and Exchange Commission ("SEC") filed this action alleging securities fraud against several individual and entity defendants in connection with the offer and sale of interests in an investment vehicle. Before the Court is Plaintiff's motion for partial summary judgment as to the sole remaining Defendant, Ross Gregory Erskine. [Dkt. No. 98] ("Motion"). The matter is fully briefed and oral argument was heard on August 17, 2023.

The central question presented is the following: Did Defendant Erskine[1] violate the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") by selling interests in LFS Funding Limited Partnership ("LFS"), and through the various representations made by Defendant in connection with those sales?

The Court answers this question in the affirmative, and for that reason ***grants*** Plaintiff's motion for partial summary judgment. From 2018-2019, Defendant worked as an unregistered broker-dealer under a false name, and sold interests in LFS, an unregistered security, using written marketing materials containing misrepresentations of the commissions to be paid. Those facts are essentially undisputed. The Court concludes based on this record that Defendant's conduct violated Sections 5(a) and (c) of the Securities Act (for the unregistered offering), violated Section 15(a) of the Exchange Act (based on Defendant's status as an unregistered broker), and constituted fraud in connection with the purchase or sale of a security in violation of both Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act.

Defendant's opposition raises three arguments in response: (1) that the LFS securities were exempt under Regulation D, Rule 506(c) because they were sold to individuals who self-certified as being "accredited investors", (2) that he cannot be considered a "broker" under the Securities Act because he did not receive "transaction based" income, and (3) that the misrepresentations concerning the Defendant's identity and commissions were not material. Defendant's Opposition to Motion for Partial Summary Judgment ("Opp.") at 5-7, 9. None of these proffered defenses has any

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[1] Since he is the sole remaining defendant, all subsequent references to "Defendant" refer exclusively to Defendant Ross Gregory Erskine.

merit. A Rule 506(c) exemption is not available where, as here, the broker does not take reasonable steps to verify the bare self-certification of an investor. 17 C.F.R. § 230.506(c). Defendant meets the definition of "broker" under 15 U.S.C. § 78c(a)(4) of the Securities Act because he did receive compensation that depended on individual transactions. *SEC v. Feng*, 935 F.3d 721, 732 (9th Cir. 2019). And Defendant's misrepresentations concerning his identity and commissions are certainly material because "there is a substantial likelihood that a reasonable investor would consider [this information] important in deciding whether to buy or sell securities." *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988); *see also SEC v. Talbot*, 530 F.3d 1085, 1097 (9th Cir. 2008). In short, Plaintiff has met its burden of establishing the elements of the four causes of action, and there are no material facts in dispute as to any of the underlying transactions at issue.[2]

II. BACKGROUND

In August 2018, Defendant Erskine was hired to solicit investments in LFS securities. *See* Statement of Uncontroverted Facts In Support of Plaintiff's Motion for Partial Summary Judgment ("SUF"), ¶ 8. From his hiring to the summer of 2019, Defendant worked as a solicitor for LFS, which involved cold-calling prospective investors, discussing the investment, and providing marketing materials including a Private Placement Memorandum ("PPM"). SUF ¶¶ 9-12, 14.

During his time soliciting investors for LFS, Defendant was not registered as a broker with

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[2] Defendant raises evidentiary objections to paragraphs 2-18 of the Declaration of SEC's Counsel Michael E. Welsh ("Welsh Decl.") and every exhibit attached to the Welsh Declaration. Defendant argues that Mr. Welsh lacks personal knowledge as to the information set forth in his Declaration, attesting to the fact that the exhibits are true and correct copies of materials produced in discovery and deposition testimony. Erskine also argues that each exhibit attached to the Welsh Declaration—from deposition transcripts to email chains—is inadmissible hearsay and has not been properly authenticated. Erskine provides no specific argument as to why each exhibit is hearsay or fraudulent.

Defendant's objections are all overruled. Defendant ignores that "Rule 56 was amended in 2010 to eliminate the unequivocal requirement that evidence submitted at summary judgment must be authenticated." *Romero v. Nevada Dep't of Corr.*, 673 F. App'x 641, 644 (9th Cir. 2016). As amended, the Rule requires that such evidence "would be admissible in evidence" at trial. *Id.* (citing Fed. R. Civ. P. 56(c)(4)). "[A]t summary judgment a district court may consider hearsay evidence submitted in an inadmissible form, so long as the underlying evidence could be provided in an admissible form at trial, such as by live testimony." *JL Beverage Co., LLC v. Jim Beam Brands Co.*, 828 F.3d 1098, 1110 (9th Cir. 2016).

the SEC. *Id.* ¶ 13. The LFS securities were also unregistered. *Id.* ¶ 6. A Form D was filed with the SEC for the LFS securities claiming an exemption from the registration requirements under Securities Act Regulation D, Rule 506(c). Declaration of Ross Gregory Erskine in Support of Opposition to Motion for Partial Summary Judgment ("Erskine Decl."), ¶ 11.

When soliciting investors, Defendant used the pseudonym "John Thompson," instead of his true name. SUF ¶ 11. Defendant also provided prospective investors a PPM that stated broker commissions from investor proceeds would be capped at $37,500 or 7.5 percent. *Id.* ¶¶ 15, 19, 23. For at least some transactions, Defendant was the only LFS representative with whom the investors communicated prior to investing. Welsh Decl. Ex. 1 at 14:11-18; *id*. Ex. 2 at 13:19-14:6.

Defendant successfully facilitated multiple investments in LFS securities. SUF ¶¶ 20-22. To effectuate the sale, Defendant instructed purchasers to sign a Subscription Agreement, fill out an Accredited Investor Questionnaire, and transfer the investment funds by check or bank wire. *Id.* ¶ 17. The Subscription Agreement asked purchasers to agree that "[T]he undersigned is at least twenty-one (21) years of age and is an 'accredited investor' as per the accompanying Accredited Investor form requirements." SUF ¶ 14 (Welsh Decl. Ex. 5 at 27). The Accredited Investor Questionnaire asked the investor to "represent[] to an issuer of securities that they [sic] undersigned; qualify as an 'Accredited Investor' pursuant to the Security Exchange Commission under the 1934 Act, as amended." *Id*. (Ex 5 at 32-33).

On or around January 28, 2019, Defendant successfully solicited an investment of $92,500 in LFS securities. Soon thereafter, Defendant received a payment totaling $23,125 from an LFS affiliated entity. SUF ¶ 20. On or around May 29, 2019, Defendant successfully solicited an investment of $50,000 in LFS securities and, the same day, received a payment from an LFS affiliated entity totaling $12,500. *Id.* ¶ 21. In total, Defendant received at least $60,625 in connection with his work selling LFS securities. *Id.* ¶ 22. Defendant did not disclose to prospective investors the amount he stood to gain in connection with their investments. *Id.* ¶ 23.

On May 20, 2021, the SEC filed its Complaint. Complaint ("Compl."), [Dkt. 1]. On October 4, 2021, Defendant filed his Answer to the Complaint. Answer ("Ans."), [Dkt. 41]. Defendant filed a Motion for Judgment on the Pleadings on October 12, 2022, which the Court denied on April 7,

2023. Shortly thereafter, on April 14, the SEC filed this Motion. After briefing completed, but before a hearing on the Motion, the case was reassigned to this Court. *See* Order of the Chief Judge [Dkt. No. 105]. The Court heard oral argument on August 17, 2023.

III. LEGAL STANDARDS

Summary judgment should be granted "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a); *accord Wash. Mut. Inc. v. United States*, 636 F.3d 1207, 1216 (9th Cir. 2011). Material facts are those that may affect the outcome of the case. *Nat'l Ass'n of Optometrists & Opticians v. Harris*, 682 F.3d 1144, 1147 (9th Cir. 2012) (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986)). A dispute is genuine "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Liberty Lobby*, 477 U.S. at 248.

The moving party bears the initial burden of establishing the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). Once the moving party has met its initial burden, Rule 56(c) requires the nonmoving party to "go beyond the pleadings and by her own affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.'" *Id.* at 324 (quoting Fed. R. Civ. P. 56(c), (e)); *see also Norse v. City of Santa Cruz*, 629 F.3d 966, 973 (9th Cir. 2010) (*en banc*) ("Rule 56 requires the parties to set out facts they will be able to prove at trial."). "If a party fails to properly support an assertion of fact or fails to properly address another party's assertion of fact . . . the court may . . . consider the fact undisputed." Fed. R. Civ. P. 56(e)(2). The Court need not "comb the record" looking for other evidence; it is only required to consider evidence set forth in the moving and opposing papers and the portions of the record cited therein. Fed. R. Civ. P. 56(c)(3); *Carmen v. S.F. Unified Sch. Dist.*, 237 F.3d 1026, 1029 (9th Cir. 2001). The Supreme Court has held that "[t]he mere existence of a scintilla of evidence . . . will be insufficient; there must be evidence on which the jury could reasonably find for [the opposing party]." *Liberty Lobby*, 477 U.S. at 252. "In judging evidence at the summary judgment stage, the court does not make credibility determinations or weigh conflicting evidence." *Soremekun v. Thrifty Payless, Inc.*, 509 F.3d 978, 984 (9th Cir. 2007).

IV. DISCUSSION

Plaintiff's Complaint asserts four claims against Defendant for violations of: (i) Section 5(a) and (c) of the Securities Act for the unregistered offering of securities; (ii) Section 15(a) of the Exchange Act for acting as an unregistered broker-dealer; (iii) Section 17(a) of the Securities Act for fraud in the offer or sale of securities; and (iv) Section 10(b) and Rule 10b-5 of the Exchange Act for fraud in connection with the sale of securities. The Court addresses each claim below.

A. Section 5(a) and (c) of the Securities Act

It is unlawful under Section 5 of the Exchange Act "to make use of any means or instruments of transportation or communications or of the mails to sell" a security without first filing a registration statement. 15 U.S.C. § 77e(a)(1); *see also* 15 U.S.C. § 77e(c). The SEC proves a Section 5 violation by showing "that (1) no registration statement was in effect as to the securities; (2) the defendant directly or indirectly sold or offered to sell securities; and (3) the sale or offer was made through interstate commerce." *SEC v. CMKM Diamonds, Inc.*, 729 F.3d 1248, 1255 (9th Cir. 2013). Plaintiff has met its burden of proof on each of these elements.

1. <u>"Securities"</u>

As a threshold matter, to predicate liability under Sections 5(a) and (c) of the Securities Act, the Court must first find that the LFS instruments at issue meet the statutory definition of securities. The undisputed facts establish beyond any doubt that the LFS instruments do satisfy this foundational requirement.

A "security" for purposes of the Securities Act can include a large number of different types of financial instruments, including an "investment contract." *See* 15 U.S.C. § 77b.[3] In *S.E.C. v. W.J. Howey Co*., the Supreme Court defined an "investment contract" as "a contract, transaction or

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[3] The term "security" is defined as "any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, ***investment contract***, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities . . . ." 15 U.S.C. § 77b(a)(1) (emphasis added).

scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." 328 U.S. 293, 298-99 (1946). The Ninth Circuit has held the definition of "investment contract" set forth in *Howey* created a three-part test requiring: "(1) an investment of money (2) in a common enterprise (3) with an expectation of profits produced by the efforts of others." *Warfield v. Alaniz*, 569 F.3d 1015, 1020 (9th Cir. 2009) (citation omitted). The third prong of this test "involves two distinct concepts: whether a transaction involves any expectation of profit and whether expected profits are the product of the efforts of a person other than the investor." *Id.*

The LFS instruments satisfy all three elements of the *Warfield* test for an investment contract. The record is clear that various individuals did in fact make "investments of money" (by wire transfer and by check) to acquire the Limited Partnership Interests. SUF ¶¶ 20-21. It is also clear that LFS pooled investor money to fund the podiatry clinics, that investors were expected to share in the revenue and losses of the venture, and that investors' returns were also linked to those of LFS – thus satisfying the "common enterprise" element. SUF ¶ 2; *see also SEC v. Glenn W. Turner Enters.*, 474 F.2d 476, 482 n.7 (9th Cir. 1973) ("the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties."). And, it is similarly undisputed that the PPM, marketing materials, and Defendant's representations clearly communicated to investors that this would be a ***passive*** investment with profits generated by the efforts of those working at the podiatry clinics. SUF ¶ 14.[4]

2. <u>No registration statement</u>

The first element of a Section 5 violation is the lack of a registration statement. *CMKM Diamonds, Inc.*, *supra*, 729 F.3d at 1255. The parties do not dispute the plain fact that no registration statement was filed for LFS Limited Partnership Interests. SUF ¶ 6. Defendant's position, however, is that Regulation D, Rule 506(c) exempts the LFS securities from the registration requirements.

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[4] Defendant has presented no facts or argument disputing the conclusion that LFS investments are "securities" within the meaning of the Act.

Opp. at 5.[5] Once the Commission establishes a prima facie violation, the defendant has the burden of proving that an exemption to the registration requirements applies. *See SEC v. Platforms Wireless International Corp*., 617 F.3d 1072, 1086 (9th Cir. 2010) (citing *SEC v. Murphy*, 626 F.2d 633, 641 (9th Cir. 1980); *SEC v. Ralston Purina Co*., 346 U.S. 119, 126 (1953)).

Under Rule 506(c) of Regulation D, securities are exempt from the registration requirement where the issuer takes reasonable care to ensure that investors are accredited investors and that they are not underwriters, and the issuer files Form D with the SEC. *U.S. Sec. & Exch. Comm'n v. Kik Interactive Inc.*, 492 F. Supp. 3d 169, 181 (S.D.N.Y. 2020) (citing 17 C.F.R. §§ 230.502, 230.506). Securities are exempt from the registration requirement under this provision where "[a]ll purchasers … are accredited investors" and the issuer "take[s] reasonable steps to verify that purchasers … are accredited investors." 17 C.F.R. § 230.506(c). Rule 506(c) outlines certain non-exclusive methods that an issuer can use to make such a verification, including examining documents that establish the purchaser's net worth or income, or relying upon written verifications by third parties such as certified public accountants or registered investment advisers. *Id*.

Here, Defendant failed to put forward ***any*** evidence to show or even suggest that LFS took steps to verify that its investors were accredited. Defendant's evidence establishes only that LFS relied on an investor's own representations—not that it took reasonable steps to ***verify*** those representations. Purchasers were required to sign a Subscription Agreement, in which the investor

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[5] Defendant initially argues that he was entitled to rely on the fact that a Form D was filed. Opp. at 5-6; *see also* Decl. of Ross G. Erskine ("Erskine Decl."), ⁋ 11. Not so. A Form D filing does not *register* the securities with the SEC. *See* 17 C.F.R. §§ 230.504, 230.506; *see also Filing a Form D Notice*, U.S. SECURITIES AND EXCHANGE COMMISSION, https://www.sec.gov/smallbusiness/exemptofferings/formd (modified Apr. 6, 2023). Moreover, case law is clear that "scienter is not a consideration" for violations of Section 5 of the Securities Act. *See S.E.C. v. Calvo*, 378 F.3d 1211, 1215 (11th Cir. 2004) (collecting cases), so Defendant's purported belief that a Form D was enough is of no consequence. Issuers file a Form D to give notice to the SEC that the issuer is engaging in the sale of unregistered securities and is claiming an exemption from registration with the SEC for the sale. *See* 17 C.F.R. §§ 230.504, 230.506. A Form D does not establish that any requirements for the exemption are in fact met, nor is it considered an application for exemption. The act of filing a Form D, therefore, provides no safe harbor. The issuer must actually meet the requirements of an exemption in order to qualify for the exemption.

agreed that "[T]he undersigned is at least twenty-one (21) years of age and is an 'accredited investor' as per the accompanying Accredited Investor form requirements." SUF ¶ 17. Investors were also required to complete an Accredited Investor Questionnaire ("Questionnaire"). *Id.* By signing the Questionnaire, an investor "represents to an issuer of securities that they [sic] undersigned; qualify as an 'Accredited Investor' pursuant to the Security Exchange Commission under the 1934 Act, as amended." *Id.* But reliance on an investor's own representations is—by definition—not verification and is therefore insufficient as a matter of law. *See SEC v. Johnson*, 2022 WL 423492, at *4 (C.D. Cal. Jan. 26, 2022) ("Whatever the minimum reasonable efforts are, the standard surely exceeds mere reliance on an investor's own representations."). Defendant presents no evidence that LFS took any steps to verify that the purchaser's representations were accurate, and, for that reason alone, the exemption does not apply.[6]

3. Sale or offer to sell securities

The second element of a Section 5 violation is the requirement that the defendant directly or indirectly offer to sell the unregistered security in question. *CMKM Diamonds, Inc.*, *supra*, 729 F.3d at 1255. Under this second prong, the SEC must also show that a defendant is "both a 'necessary participant' and a 'substantial factor' in the sales transaction." *S.E.C. v. Phan*, 500 F.3d 895, 906 (9th Cir. 2007) (quoting *SEC v. Murphy*, 626 F.2d 633, 652 (9th Cir. 1980)). The test for whether someone was a necessary participant in an offering is "whether, but for the defendant's participation, the sales transaction would not have taken place." *Murphy*, 626 F.2d at 651. The substantial factor prong is akin to proximate causation. *Id.*

Here, multiple investors testified that Defendant, using the alias "John Thompson," called them and provided information about the investment opportunity and that "John Thompson" was the ***sole*** point of contact prior to their investment. Welsh Decl. Ex. 1 at 14:11-18; *id.* Ex. 2 at 13:19-

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[6] A cursory review of the Questionnaire shows why it is plainly insufficient. Investors were not required to submit documentation to support their status. SUF ¶ 17. Indeed, the Questionnaire merely asks investors to provide their completed education, investment experience, and tax bracket—none of which could enable LFS to verify the investor's status. *Id.*

14:6. Defendant admits in his Answer that he spoke with investors as a “marketer” of the investments. Ans. ¶¶ 5, 9. In short, there is no genuine dispute that, without Defendant’s outreach and marketing efforts, the investments would not have taken place. Defendant’s conduct directly facilitated the sales—making him both a necessary participant and substantial factor in the offering or sale of the LFS securities.

4. Sale made through interstate commerce

The third and final prong necessary for a Section 5 violation is a showing by the SEC that the sale or offer was made through interstate commerce. *See* IV.A., *supra*. That element is also not disputed in Defendant’s Opposition. Nor could it be. The undisputed facts establish that Defendant solicited investors in LFS through telephone and email, and consummated sales of these unregistered securities, in writing, using similar means. SUF ¶ 11. That is sufficient. *See, e.g., S.E.C. v. Spinosa*, 31 F. Supp. 3d 1371, 1376 (S.D. Fla. 2014) (“Use of the mail, telephone, and internet satisfies [the interstate commerce] requirements [of the Securities Act and the Exchange Act].”).

B. Section 15(a) of the Securities Act

Section 15(a) of the Exchange Act prohibits any broker or dealer not registered with the SEC from using instrumentalities of interstate commerce to effect or attempt to induce any transactions in securities. 15 U.S.C. § 78o(a)(1). The Exchange Act defines a “broker” as “any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank.” 15 U.S.C. § 78c(a)(4). The purpose of Section 15(a)’s broker registration requirement is to ensure that “securities are [only] sold by a salesman who understands and appreciates both the nature of the securities he sells and his responsibilities to the investor to whom he sells.” *Roth v. S.E.C.*, 22 F.3d 1108, 1109 (D.C. Cir. 1994). Section 15(a) does not require a showing of scienter;[7] the SEC must simply establish that the defendant was not registered with the SEC and acted as a broker or dealer in offering or selling securities. *SEC v. Interlink Data Network of Los Angeles, Inc.*, 1993 WL 603274 (C.D. Cal. Nov. 15, 1993).

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[7] Defendant’s belief that he was not required to register as a broker is irrelevant and does not shield him from liability under Section 15.

In determining whether an actor is a broker under the Act, courts consider whether the individual "(1) is an employee of the issuer of the security; (2) received transaction-based income such as commissions rather than a salary; (3) sells or sold securities from other issuers; (4) was involved in negotiations between issuers and investors; (5) advertis[ed] for clients; (6) gave advice or made valuations regarding the investment; (7) was an active finder of investors; and (8) regularly participates in securities transactions." *SEC v. Feng*, 935 F.3d 721, 732 (9th Cir. 2019) (alteration in original) (citing *SEC v. Feng*, No. 15-cv-09420, 2017 WL 6551107, at *7–8 (C.D. Cal. Aug. 10, 2017)); *see also Sec. & Exch. Comm'n v. Hansen*, No. 83 CIV. 3692, 1984 WL 2413, at *10 (S.D.N.Y. Apr. 6, 1984) (setting forth the "*Hansen* factors").

Here, Plaintiff submitted evidence supporting all the required elements of Section 15(a)—namely, that Defendant worked as a broker, SUF ¶¶ 9-11; was admittedly unregistered, *id.* ¶ 13; regularly participated in securities transactions using the instrumentalities of interstate commerce, *id.* ¶¶ 10-13, 20-22; made representations to investors regarding the merits of investments, *id.* ¶ 12; actively found investors, *id.* ¶¶ 9-10; and received transaction-based income, *id.* ¶¶ 20-22. Defendant's principal argument in response is that he is not a "broker" within the meaning of the Securities Act because he received compensation in the form of a purported "discretionary bonus" and not a commission. Opp. at 7. In support of this argument, Defendant cites to a definition of "commission" from the California Labor Code for the proposition that a discretionary bonus that an employer can choose to pay or withhold, such as a performance bonus, is not a commission even if it is computed as a percentage of sales or profits. *Id.*

Defendant misunderstands the inquiry here. The test is not whether compensation qualifies as a commission, but rather whether the compensation was "transaction-based." *See, e.g.*, *S.E.C. v. StratoComm Corp.*, 2 F. Supp. 3d 240, 263 (N.D.N.Y. 2014) ("Danzig also received transaction-based compensation in the form of a discretionary bonus that depended on how much money he raised for StratoComm by selling its securities to investors. Accordingly, the undisputed facts in this case establish that Danzig acted as an unregistered broker."). Here, Defendant has admitted that the discretionary bonuses he was paid were tied to his sales of LFS securities. Erskine Decl., ¶ 4. And the near-instantaneous temporal connection between his successful solicitations and his compensation payments—*e.g.*, on January 30, 2019, he received payment ***two days*** after obtaining the investment (SUF ¶ 20); on May 29, 2019, he received compensation the ***same day*** as he obtained that investment (SUF ¶ 21)—belies any argument that these payments were somehow miscellaneous bonuses unrelated to the transactions themselves. To argue otherwise strains all credulity.[8]

C. Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5

Plaintiff also brings claims for securities fraud under Sections 17(a), 10(b), and Rule 10b-5. The legal standards under these sections contain significant overlap, and the SEC bases each claim on the same conduct by Defendant.

Section 17(a)(2) of the Exchange Act makes it unlawful "to obtain money or property by means of any untrue statement of a material fact or any omission" of a material fact in the offer or sale of a security by the use of interstate commerce. 15 U.S.C. § 77q(a)(2). To prove a Section 17(a)(2) violation, the SEC must demonstrate that a defendant: (1) by means of interstate commerce; (2) obtained money or property; (3) by means of a material false statement or omission; and (4) acted at least negligently. *See SEC v. Dain Rauscher, Inc*., 254 F.3d 852, 856 (9th Cir. 2001).

Section 10(b) forbids the "use or employ[ment], in connection with the purchase or sale of any security[,] ... [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b). **SEC Rule 10b-5** implements Section 10(b) by declaring it "unlawful:

> a. To employ any device, scheme, or artifice to defraud,
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> b. To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading, or

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[8] In a related argument, Defendant contends that Section 201(c) of the JOBS Act bypasses the requirement of broker registration and exempts him from liability. *See* Opp. 6-7. This statutory provision relieves a person from liability for offering securities as an unregistered broker only if that person "receives no compensation in connection with the purchase or sale" of a security. 15 U.S.C. § 77d(c)(2)(A). That argument fails for the same reason discussed above.

c. To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

17 C.F.R. § 240.10b-5. To establish a violation of Section 10(b) and Rule 10b-5(b), the SEC must show that a defendant "(1) made a material misrepresentation or omission (2) in connection with the purchase or sale of a security (3) with scienter (4) in interstate commerce." *SEC v. Platform Wireless Int'l Corp.*, 617 F.3d 1072, 1092 (9th Cir. 2010).

For all the reasons discussed in Section IV. A. and B, *supra*, Plaintiff has met its burden of proof on each of the elements above. The Court concludes that there are no genuine disputes of material facts regarding the underlying transactions.

Defendant's Opposition raises two arguments in response to these claims: (1) that the misstatements that form the basis of the SEC's claims were not material, and (2) that Defendant did not act with the requisite state of mind to be found liable for securities fraud. Opp. at 8-10. Both arguments fail as a matter of law and are unsupported on the basis of the undisputed record.

1. Materiality

A fact is material if there is a substantial likelihood that its disclosure "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc*, 485 U.S. at 231–32; *see also Talbot*, 530 F.3d at 1097 (stating that a fact is material "if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether to buy or sell securities"). "[T]he standard of materiality is judged from the perspective of a 'reasonable investor,' and is therefore an objective one." *United States v. Reyes*, 660 F.3d 454, 468 (9th Cir. 2011) (internal quotation omitted).

The SEC bases its fraud claims on two repeated misstatements by Defendant. First, Defendant distributed PPMs that falsely stated broker commissions from investor proceeds would be capped at $37,500 or 7.5 percent—in reality, LFS brokers, including Defendant received commissions up to 31 percent of each investment. SOF ¶¶ 15, 19, 23. Second, Defendant misrepresented his identity as "John Thompson," *id.* ¶ 11, which the SEC argues was intended to lead investors to believe Defendant was a registered broker, like the real John Thompson. The SEC also argues Defendant used the alias in connection with the securities sales to prevent investors from learning of a previous enforcement action against Defendant by the CFTC. Mot. at 14-15.

The Court finds Defendant's misrepresentations and omissions to be material as a matter of law. Courts have repeatedly found materiality in similar misrepresentations concerning commissions and use of investment funds. In *SEC v. All. Leasing Corp*., 28 Fed. Appx. 648 (9th Cir. 2002), for example, defendant failed to disclose to investors a 30% commission on the securities sale. The Ninth Circuit found that "the 30% commissions were 'so obviously important to an investor, that reasonable minds cannot differ on the question of materiality.'" *Id*. at 652 (quoting *TSC Indus. Inc., v. Northway, Inc*., 426 U.S. 438, 450 (1976)); *see also United States v. Laurienti*, 611 F.3d 530, 541 (9th Cir. 2010) (finding "a reasonable investor would consider it important that, in contrast to the purchase of most stocks, the broker would receive a 5% commission from the purchase of this particular (house) stock," and therefore "reject[ing] Defendants' argument that the bonus commissions are immaterial as a matter of law"); *see also Schaffer Family Inv'rs LLC v. Sonnier*, 2016 WL 6917269, at *6 (C.D. Cal. July 5, 2016) (finding defendant's misrepresentation that he did not have any financial benefit in connection with investments made by plaintiffs material as a matter of law where defendant did in fact receive finder's fees and commissions in connection with the investments); *see also SEC v. Research Automation Corp*., 585 F.2d 31, 35-36 (2nd Cir. 1978) (misleading statements and omissions about the use of investor funds were material as a matter of law); *see also SEC v. Holschuh*, 694 F.2d 130, 144 (7th Cir. 1982) (failing to use proceeds for promised mining operations was material). In light of the abundance of precedent, the Court believes that reasonable investors in this context would consider the up-to-31-percent commissions here important in deciding whether to buy the securities.[9]

The Court also finds Defendant's use of the false name "John Thompson" to be a material misrepresentation. Defendant argues that the CFTC action against him was dismissed, and therefore

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[9] Although Defendant did not raise the point, one of the investors deposed stated that knowing about the 25 to 31 percent commissions "wouldn't have deterred the investment." Welsh Decl. Ex. 2, 20:8-18. Standing alone, the Court finds this testimony insufficient to create a genuine dispute of fact as to materiality—especially given the wealth of caselaw holding otherwise.

that he had no disciplinary history to hide. Erskine Decl. ¶ 12. Perhaps. But the Court finds his misappropriation of a registered broker's name to be material standing alone.[10] Unlike Defendant, John Thompson was a registered broker with the SEC. SUF ¶ 13; Mot. at 14. If potential investors researched the name of the broker presenting them with the offer, they easily could be left with the impression that they were communicating with a registered broker—thereby cloaking Defendant in legitimacy that he lacked. The Court finds that a reasonable investor would consider the identity, expertise, and credentials of the broker offering an investment opportunity important in deciding whether to purchase the securities.

2. <u>Scienter</u>

"Violations of Section 17(a)(1), Section 10(b) and Rule 10b–5 require scienter. ... Violations of Sections 17(a)(2) and (3) require a showing of negligence." *Phan*, 500 F.3d at 908 (quoting *Dain Rauscher*, 254 F.3d at 856). Scienter may be established "by showing that the defendants knew their statements were false, or by showing that defendants were reckless as to the truth or falsity of their statements." *Gebhart v. S.E.C.*, 595 F.3d 1034, 1041 (9th Cir. 2010). "[R]eckless conduct may be defined as a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Hollinger v. Titan Cap. Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990) (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir.)).

In this action, Defendant distributed PPMs to potential investors containing false statements including a cap on broker commissions that was far lower than the actual compensation. SUF ¶¶ 14-15. Surely, as Defendant personally received compensation far in excess of the cap described in the PPMs, SUF ¶¶ 20-21, he knew these statements to be false. But to the extent Defendant argues that he was ignorant of these false statements, distributing materials regarding the LFS securities offering without knowing the contents of the materials is evidence of reckless conduct in itself. *See S.E.C. v.*

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[10] Defendant presented no evidence to explain why the alias was used and failed to articulate any reason he would pick the name of a ***registered broker***.

Helms, 2015 WL 6438872, at *4 (W.D. Tex. Oct. 20, 2015) ("[D]efendant's failure to read the terms of the securities offering is, at best, reckless disregard for this duty."). And there can be no question that Defendant knew he was misrepresenting his identity to investors when using the alias "John Thompson."

In summary, despite knowing the PPMs false statements, Defendant failed to correct the misstatements or disclose the transaction-based compensation he was to receive. SUF ¶ 23. This conduct, in the context of an unregistered securities offering, is—at best—reckless disregard for the truth or falsity of his statements.

3. Fraudulent Scheme

Plaintiff also predicates its Section 17(a) and 10(b) claims on an alternative theory that Defendant engaged in a fraudulent scheme. Section 17(a)(1) and (3) of the Exchange Act makes it unlawful for any person in the offer or sale of any securities "to employ any device, scheme, or artifice to defraud" or "to engage in any transaction, practice, or course of business which operates or would operate as fraud or deceit upon the purchaser." 15 U.S.C. § 77q(a)(1), (3). Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c) similarly make it unlawful, in connection with the purchase or sale of a security, "to employ any device, scheme, or artifice to defraud" or "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person" in connection with the purchase or sale of any security. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5(a), (c). Section 17(a)(3) claims require negligence, and Section 17(a)(1), Section 10(b), and Rule 10b-5 claims require scienter. *Dain Rauscher*, 254 F.3d at 856.

The required elements are met here. In 2018, LFS and Michael Thompson hired Defendant and others to solicit prospective investors for the LFS securities. SUF ¶ 4; Erskine Decl. ¶ 2. The PPMs created and distributed by LFS and the other Defendants misled investors regarding the use of their invested funds to pay large commissions to unregistered brokers. SUF ¶¶ 15, 19. Defendant participated in this scheme by soliciting investors and distributing materially false statements through the PPMs, and received over $60,000 in transaction-related bonuses for his role in the scheme. *Id.* ¶ 14, 22. Defendant provides no evidence to rebut these facts. The Court finds that Defendant engaged in a fraudulent scheme in violation of Section 17(a) and Section 10(b).

V. CONCLUSION

For the reasons stated herein, Plaintiff's Motion for Partial Summary Judgment is ***granted***.

IT IS SO ORDERED.

Dated: August 25, 2023

Hernán D. Vera
United States District Judge