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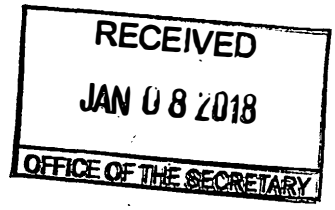
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-16182

In the Matter of

PAUL EDWARD "ED" LLOYD, JR., CPA

Respondent.

****

RESPONDENT'S RESPONSE TO ORDER SCHEDULING SUBMISSION OF NEW EVIDENCE, AND BRIEF IDENTIFYING CHALLENGED RULINGS, FINDINGS OR CONCLUSIONS

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By Order dated December 12, 2017, the Administrative Law Judge assigned to this case ordered that each party may submit, by January 5, 2018, new evidence deemed relevant to a reexamination of the record, along with a brief explaining the relevance of the new evidence, and identifying any challenged rulings, findings or conclusions.

The Respondent, Paul Edward "Ed" Lloyd, Jr., CPA, does not wish to submit any new evidence. However, Respondent does challenge certain rulings, findings and conclusions previously set forth in the Initial Decision in this matter.

I. MATTERS BEFORE THE TRIBUNAL

The requested corrections of findings of fact and conclusions of law are substantially those requested in Respondents Proposed Corrections of Manifest Errors of Fact in the Initial Decision (August 6, 2015), and the issues below are also all briefed in respondents Brief in Support of Petition for Review to the Commission (November 9, 2015).

A. RESPONDENT REQUESTS CORRECTION OF THE FOLLOWING ERRONEOUS FINDINGS OF FACT.

1. The finding that the membership units in the Maple Equestrian, Piney Cumberland Holdings, and Meadow Creek Holdings LLC's were issued pursuant to Regulation D.

2. The finding that Respondent's failure to inform LPL of the conservation easement transactions was inconsistent with LPL's compliance policies relating to selling away, outside business activities, and providing tax advice.

3. The finding that Respondent did not provide OCIE with the revised Schedule I listing 15 members of FC 2012, LLC.

4. The finding that Ray Branch and Respondent's attorneys discussed Respondent's fees.

5. The finding that Respondent had the opportunity to influence Mark Losby's memory of his FC 2012 participation.

6. The finding that Respondent had the opportunity to influence Larry Price's memory of his FC 2012 participation.

7. The finding that Respondent may have stolen $130,000.00 from his clients outright had he not been examined by OCIE.

8. The finding that Respondent possessed independent contractor-like autonomy while associated with LPL making him more like a controlling person of an investment adviser rather than an employee of same.

9. The finding that Respondent should not be able to avoid primary liability by selling away.

10. The finding that Respondent's failure to inform SFA and PCH of the identities of the ultimate consumers undermined those entities' compliance efforts and created the potential for a conflict of interest.

11. The finding that but for his deceit of SFA, none of Respondent's clients could have participated in FC 2012, and he would not have been entitled to any of his fees.

12. The finding that Respondent created a risk that SFA and PCH would violate the securities laws.

B. RESPONDENT REQUESTS CORRECTION OF THE FOLLOWING ERRONEOUS CONCLUSIONS OF LAW.

1. The conclusion that Respondent was an investment adviser and subject to the IAA.

2. The conclusion that Respondent did not qualify for the accountant's exception to the definition of investment adviser under the IAA.

3. The conclusion that Respondent committed a primary violation of Section 206(4) of the IAA.

C. RESPONDENT REQUESTS REVERSAL OF THE FINDINGS OF VIOLATION OF THE INVESTMENT ADVISORS ACT BECAUSE OF DUE PROCESS VIOLATIONS OCCURRING IN THIS MATTER.

D. RESPONDENT REQUESTS CORRECTION OF ERRORS IN THE IMPOSITION OF SANCTIONS.

1. A cease-and-desist order was moot and inappropriate.

2. The associational bar was inappropriate.

3. The calculation of disgorgement was erroneous.

4. The civil penalty assessed was excessive and unsupported by the evidence.

II. ARGUMENT

A. RESPONDENT REQUESTS CORRECTION OF THE FOLLOWING ERRONEOUS FINDINGS OF FACT.

The ID rendered on July 27, 2015 made conclusions of material fact that were clearly erroneous based upon the evidence and testimony presented during the Hearing. The erroneous findings discussed *infra* remained part of the ID after ALJ Elliot issued the Order on Motion to Correct Manifest Errors of Fact on August 18, 2015.

1. The finding that the membership units in the Maple Equestrian, Piney Cumberland Holdings, and Meadow Creek Holdings LLC's were issued pursuant to Regulation D (Item 1 in Respondent's Proposed Corrections for Manifest Errors of Fact).

Erroneous Finding: "Each of the three conservation easements in suit involved a property owner who created a limited liability company which issued membership units pursuant to Reg D. Tr. 99-100, 445-46; Div. Exs. 151, 152, 153. The three limited

liability companies/issuers and their associated Reg D offerings were named Maple Equestrian, LLC (Maple Equestrian), Piney Cumberland Holdings, LLC (Piney Cumberland), and Meadow Creek Holdings, LLC (Meadow Creek)." (ID at 6.)

The erroneous finding, as amended, still states that membership units were issued "pursuant to regulation D" and that the offerings were "Reg D offerings." In light of the prior determination that the membership units were not securities, they could not have been offered "pursuant to Regulation D," which exempts from registration only certain qualified offerings of *securities*. *See* 15 U.S.C. 77d(a)(5); 15 U.S.C. 77e.

An interest in an LLC that is not a "security" is not subject to the securities laws, or Regulation D, at all. SFA's erroneous belief that the interest might have been a security does not make it one; you can call a cow a dog, but that won't make it bark. It was determined in this action that the interest in the LLC was not a security. Consequently, any reference to Regulation D (except to point out that the LLC's were under the erroneous assumption that the offerings were securities and exempt from registration under Regulation D) was manifest error as it allowed irrelevant evidence into the pool for consideration by the ALJ, and it essentially allowed the Division to ignore the Order on Summary Disposition, as illustrated by the Division's counsel repeatedly referring to the offerings as "securities" and the ALJ repeatedly overruling Respondent's objection to same. The reference to Regulation D should be stricken. *See* Admin. Proc. Rulings Release No. 2366.

2. The finding that Respondent's failure to inform LPL of the conservation easement transactions was inconsistent with LPL's compliance policies relating to selling away, outside business activities, and providing tax advice (Item 3 in

Respondent's Proposed Corrections for Manifest Errors of Fact).

Erroneous Finding: "The participation in SFA-Broker private offerings by his clients and himself and Lloyd's failure to inform LPL of them, were inconsistent with LPL's compliance policies relating to selling away, outside business activities and providing tax advice." (ID at 19.)

LPL's compliance policies are entirely irrelevant to the issue of whether or not Respondent violated the IAA because he was not acting in his capacity as an investment adviser, and the conservation easements at issue were not securities, as determined by ALJ Foelak. *See Paul Edward "Ed" Lloyd, Jr., CPA*, Admin. Proc. Rulings Release No. 2366, 2015 SEC (Feb. 27, 2015). The LPL compliance policies (DOE Ex. 154-155) should not have been admitted into evidence, nor should they have been examined. That they were was error. The extensive questioning about the policies was nothing more than evidence of "bad acts" or "bad character" irrelevant to any issue in the case, an objection raised by Respondent, but overruled.

Because the interests in Maple Equestrian, Piney Cumberland, and Meadow Creek were not securities, Respondent's offer to his clients was not "selling away," either by FINRA rule or the compliance manual, both of which refer to private *securities* transactions. *See also* Dethlefsen Testimony (Tr. 319). Respondent's CPA and tax practice was disclosed to LPL and reflected on the BrokerCheck report. As noted by the Court, Respondent's CPA and tax practice was known to LPL, without objection.

Because the transaction was part of Respondent's CPA practice, it was not an undisclosed "outside business activity." LPL and its policies had no place in the

hearing, and they have no place in the ID. The Division's questions predicated on Respondent failing to disclose his participation in the LLC's were improper. The Finding in question should be stricken.

3. The finding that Respondent did not provide OCIE with the revised Schedule I listing 15 members of FC 2012, LLC (Item 4 in Respondent's Proposed Corrections for Manifest Errors of Fact).

Erroneous Finding: "Lloyd did not provide OCIE with the revised Schedule I, listing 15 members, that he had provided to SFA and the Piney Cumberland issuer on both December 10 and 11 of 2012." (ID at 20.)

The ID, as amended, insinuates that Respondent never provided OCIE with the revised Schedule I which listed the 15 members. ALJ Elliot is correct in his Order on Motion to Correct Manifest Errors of Fact that Respondent did not provide the revised Schedule I in the March 14, 2013 production, but to state only that Respondent "did not provide OCIE with the revised Schedule I . . ." is simply false. The finding suggests that Respondent was purposefully hiding that version of the document from OCIE, but there is no evidence to support such a claim. Respondent provided the document in his April 5, 2013 production. The ALJ should consider *all* of the relevant facts, not those that fit the narrative the Division created and he adopted. The finding should be amended as requested in Item 4 of Respondent's Motion.

4. The finding that Ray Branch and Respondent's attorneys discussed Respondent's fees (Item 5 in Respondent's Proposed Corrections for Manifest Errors of Fact).

Erroneous Finding: "Branch and Lloyd's attorneys discussed fees Lloyd charged, among other things. Tr. 1102." (ID at 22.)

This finding reflects a contention (or innuendo) advanced repeatedly by the Division, without any factual support, that the responses of Respondent's clients were somehow influenced by Respondent or his counsel. It was unsupported by the evidence submitted at the Hearing, and omits relevant information required to make it not a misrepresentation: Branch's uncontested testimony was that his discussions with Respondent's counsel occurred after he responded to the subpoena (Tr. 1097, 1102) and that he knew the fee *at the time he wrote the check* (Tr. 1089-90). Moreover, several clients testified specifically that Respondent did not help them draft their letters or suggest language to include in their response. (Losby 942:5; Hooks 1080:16-1081:1; Price 1110:7-12; Goss 1133:20-1134:12.)

In the Order on Motion to Correct Manifest Errors of Fact, the ALJ states that this sentence is supported by the cited evidence. However, the testimony speaks for itself and contradicts the finding. The finding to the contrary is patently false and blatantly ignores the actual testimony, adding one more unsupported allegation to the pile of "facts" that undoubtedly influenced the tribunal's opinion of Respondent and the resulting decision. The finding should be corrected as set forth in Item 5 of Respondent's Motion to Correct Manifest Errors.

5. The finding that Respondent had the opportunity to influence Mark Losby's memory of his FC 2012 participation (Item 6 in Respondent's Proposed Corrections for Manifest Errors of Fact).

Erroneous Finding: "However, Losby testified that he turned to Lloyd when he first received the document subpoena from commission staff, meaning Lloyd had the

opportunity to influence Losby's memory of his FC12 participation. Tr. 937-38, 942-43." (ID at 24.)

There is a difference between having an *opportunity* to influence someone and actually using that opportunity to do so. The ID selectively recounts facts to suggest an improper influence on the testimony of several witnesses by Respondent or his counsel when, in fact, Losby confirmed his independent and uninfluenced recollection. *See* Tr. 938-39, 941; DOE Ex. 134. This skewed recitation of the testimony clearly shows the ID reflects either an erroneous understanding of what was said, a blind acceptance of the Division's narrative regardless of the evidence, or a selective recasting of the actual testimony. While everyone is entitled to their own opinions, no one is entitled to their own facts. The finding should be corrected as set forth in Item 6 of Respondent's Motion to Correct Manifest Errors.

6. The finding that Respondent had the opportunity to influence Larry Price's memory of his FC 2012 participation (Item 7 in Respondent's Proposed Corrections for Manifest Errors of Fact) .

Erroneous Finding: "Like Losby, however, Price was in contact with Lloyd just after receiving a document subpoena from the Commission staff. Tr. 1117-19." (ID at 24.)

Again, the finding suggests improper influence and conduct thorough a selective recitation of the evidence. *See* Tr. 1109-1110; 1118; Division Ex. 140. It is clear after many incorrect summaries of the trial testimony that the ALJ heard only the Divisions narrative, despite the fact that the actual testimony is in the record, in black and white.

The finding should be corrected as set forth in Item 7 of Respondent's Motion to Correct Manifest Errors.

7. The finding that Respondent may have stolen $130,000.00 from his clients outright had he not been examined by LPL and OCIE (Item 8 in Respondent's Proposed Corrections for Manifest Errors of Fact).

Erroneous Finding: "Make no mistake, Lloyd may not have issued true and correct K-1s absent the focus on him in early 2013 by LPL and OCIE. *See* Resp. Reply at 9-10. It is entirely possible that, had LPL and OCIE never examined Lloyd, he would have stolen $130,000.00 from his clients outright." (ID at 28.)

The ALJ made an excellent point in his Order on Motion to Correct Manifest Orders: This finding is "not factual." That is precisely Respondent's point. This sentence is hypothetical, gratuitous speculation, unsupported by any evidence and suggestive of a biased mindset towards Respondent. It was erroneous to even consider this hypothetical, much less to include it in the ID. Its inclusion was one more example of the absence of a "neutral and disinterested fact finder" in this proceeding. It should be corrected by being stricken in its entirety, or as set forth in Respondent's Motion to Correct Manifest Errors.

8. The finding that Respondent possessed independent contractor-like autonomy while associated with LPL making him more like a controlling person of an investment adviser rather than an employee of same (Item 9 in Respondent's Proposed Corrections for Manifest Errors of Fact).

Erroneous Finding: "The independent contractor-like autonomy he possessed while associated with LPL made him much more like a controlling person of an investment advisor than an employee of an investment advisor..., further with respect to

his advisory clients, Lloyd engaged in conduct virtually indistinguishable from that than of an unregistered investment advisor. It would be anomalous if Lloyd could only be held secondarily liable for conduct that would warrant primary liability for an unregistered investment advisor" (citations omitted). (ID at 29.)

There is no *factual* support for a conclusion concerning Respondent's supposed autonomy, authority, or ability to influence, and none was cited in the ID. The nature of his relationship with LPL and his autonomy (or lack thereof) was never discussed, nor was the nature of any investment advisory service he provided to a very small number of clients ever explored. LPL's knowledge (or not) of Respondent's practice was not explored, except it was clear that LPL was aware of his accounting practice (see Tr. 552, 718, BrokerCheck Report,).

On a number of occasions in the ID and at the Hearing, the Court stated that Respondent was an "associated person" with a Registered Investment Advisor, LPL. By definition, he was at most an "associated person." 15 U.S.C. § 80b-2(a)(17) (2014). There is simply no factual predicate for the finding that he was "like" an independent contractor or that he had any "control" over LPL. Moreover, a finding that Respondent was an independent contractor and yet in "control" of the Investment Advisor, LPL, is fundamentally inconsistent.

In short, Respondent's level of autonomy with respect to his work with LPL was not explored during the hearing, and no finding as to his status as an investment adviser is appropriate. Most importantly, because Respondent's liability under the IAA turns *specifically* on whether or not he was an "investment adviser," it is manifest error to rule on Respondent's status as such. The statement should be stricken.

9. The finding that Respondent should not be able to avoid primary liability by selling away (Item 10 in Respondent's Proposed Corrections for Manifest Errors of Fact).

Erroneous Finding: "It would be particularly anomalous if he could avoid primary liability by the simple expedient of selling away." (ID at 29.)

There is no evidence that Respondent was "selling away" because the interests in FC 2012 were not "securities," nor were they even investments. To be "selling away" Respondent would have to be selling *securities*, and he was not.

Again, this finding has no place in the ID, nor did it have a place in the Hearing. ALJ Foelak's Order on Motion for Summary Disposition was quite clear that the interests at issue were not securities, and any discussion or hypothetical regarding securities was irrelevant and therefore manifest error. ALJ Elliot allowed the Division to present its case as it would have if ALJ Foelak had not granted summary disposition, which resulted in hours of irrelevant evidence, and improper questioning, and to the extent it was relied upon by ALJ Elliot when determining what, if any, violations of the Advisers Act occurred, such evidence was improper and insufficient. The statement should be stricken.

10. The finding that Respondent's failure to inform SFA and PCH of the identities of the ultimate consumers undermined those entities' compliance efforts and created the potential for a conflict of interest (Item 12 in Respondent's Proposed Corrections for Manifest Errors of Fact) .

Erroneous Finding: "More specifically, Lloyd's failure to inform SFA and Piney Cumberland of the identities of the ultimate customers undermined those entities' compliance efforts, created a risk that they may violate the suitability and disclosure

provisions of the securities laws, and, in Carson's case, potentially created a conflict of interest between SFA and Merrill Lynch." (ID at 33-34.)

Because neither the participation in PCH nor FC 2012 constituted the purchase of a "security," there was no risk of interfering with SFA or PCH's efforts at compliance with Regulation D, or securities laws, and no risk that they would violate suitability or disclosure provisions or create any conflict of interest.

Once again, the ALJ referenced hypothetical problems arising out of issues already decided by ALJ Foelak and ignored the fact that these transactions did not involve the purchase or sale of a security. The finding is also entirely speculative because there was no evidence to support the potential compliance threat. Based on the language of the ID, it appears that the ALJ considered hypothetical compliance issues that "could" have arisen, had securities been in play, and this was clearly in error. The statement should be stricken.

11. The finding that but for his deceit of SFA, none of Respondent's clients could have participated in FC 2012, and he would not have been entitled to any of his fees[1] (Item 13 in Respondent's Proposed Corrections for Manifest Errors of Fact).

Erroneous Finding: "Lloyd's own testimony establishes, but for his deceit of the SFA, his clients could not have participated in FC12 and he would not have been entitled to his fees. Tr. 809, 812-13. Thus, the amount he was enriched as a result of his deceit, $105,750.00 should be disgorged. Div. Exs. 67, 102, 109, 110, 187." (ID at 35.)

[1] Respondent maintains that no disgorgement was appropriate and that no improper benefit was received. However, the Court ordered disgorgement of fees that would not have been obtained "but for" the misrepresentation to SFA. If the ruling remains the same, the factual predicate should reflect only those fees relating to the misrepresentation, not unrelated fees.

This finding, and the resulting finding regarding disgorgement, rests upon a speculative premise that had Carson, Brown, and Malloy not participated in the FC 2012 entity, the entire transaction between FC 2012 and PCH, LLC would not have occurred. The testimony cited in the ID does not support this conclusion.

Indeed, as Respondent testified, one option was to reduce the total participation of FC 2012 in PCH; have the money that was wired returned (consistent with testimony of PCH's attorney); return Carson, Brown, and Malloy's funds to them; and simply participate in a lesser amount with money received from the 15 participants. Respondent would still have received fees from the other 15 participants, and he would have forgone only the fees from Carson, Brown, and Malloy, a total of $20,500. (*See* Division Ex. 187.) It is erroneous and contradicts the evidence and testimony presented at the hearing to hold that *none* of Respondent's clients could have participated in the PCH transaction without the inclusion of Carson, Brown, and Malloy. The statement should be corrected as set forth in Item 13 of Respondent's Motion to Correct Manifest Errors.

12. The finding that Respondent created a risk that SFA and PCH would violate the securities laws (Item 14 in Respondent's Proposed Corrections for Manifest Errors of Fact).

Erroneous Finding: "On the other hand, although there was no demonstrated harm to Lloyd's clients, and the Piney Cumberland interests were not securities, by circumventing the compliance processes at SFA and Piney Cumberland, Lloyd created a risk that those entities would violate the securities laws." (ID at 36.)

Because neither the participation in PCH nor FC 2012 constituted the purchase of a "security," there was no risk of interfering with SFA or PCH's efforts at compliance

with Regulation D or securities laws, and the ID cited no evidence in the record showing how such a violation or conflict of interest might occur absent a sale of a security. Once again, the ALJ appears to have weighed a completely irrelevant and hypothetical situation, rather than examining only the actual facts and evidence presented during the hearing, making this finding erroneous. The statement should be corrected as set forth in Item 14 of Respondent's Motion to Correct Manifest Errors.

B. RESPONDENT REQUESTS CORRECTION OF THE FOLLOWING ERRONEOUS CONCLUSIONS OF LAW.

The ALJ erred in finding that Respondent was an investment adviser who acted in his investment advisory capacity during the FC 2012 transaction, and in failing to find that Respondent's actions were within the "accountant's exception" to the IAA. The ALJ also erred in finding that Respondent committed a primary violation of Section 206(4) of the IAA.

The ID initially, and correctly, noted that there is a definitional difference between an investment adviser and a person associated with an investment adviser. (*See* ID at 25.) The Definitions section of the IAA defines an "investment adviser" as:

> any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.

15 U.S.C. 80b-2(11). A "person associated with an investment adviser," includes ". . . any person directly or indirectly controlling or controlled by such investment adviser, including any employee of such investment adviser." 15 U.S.C. § 80b-2(a)(17) (2014).

"Section 206 is an anti-fraud provision and applies only to 'investment advisers.'" *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 464 F. Supp. 528, 537 (D. Md. 1978); *Hall v. Paine, Webber, Jackson & Curtis, Inc.*, No. 82 CIV. 2840 (DNE), 1984 WL 812, at *2 (S.D.N.Y. Aug. 27, 1984). In order to be charged with a primary violation of Section 206, the individual must be an "investment adviser." *Russell W. Stein*, Securities Exchange Act of 1934 Release No. 47504, 2003 WL 1125746, at *3 (Mar. 14, 2003). "'Persons associated with investment advisers' must be charged as aiders and abettors." *Id.*

The ID found that Respondent violated Section 206(4) of the IAA based on the misrepresentations he made to SFA. In 2012, at the time of the conservation easement transaction, Respondent was a registered representative of LPL Financial. By definition, he was a "person associated with an investment adviser." 15 U.S.C. § 80b-2(a)(17) (2014). He quite literally could not be an "investment adviser" for purposes of the IAA, based on both the definitions above as well as the *Stein* holding, and he could not commit a primary violation of Section 206. The ID's finding as to this issue was erroneous.

In the alternative, even if Respondent was deemed to be an investment adviser, he did not violate Section 206 because he was not acting as an investment adviser during the FC 2012 transaction, and he fell within the accountant's exception under the IAA. Respondent, and the participants who testified, noted that this transaction was a tax saving technique used with Respondent's tax clients. That four of them were also investment advisory clients does not change the nature of the transaction. This charitable deduction is no different than gifting appreciated property to a charity. That is

precisely why all communications utilized Respondent's Ed Lloyd & Associates email address and letterhead instead of Lloyd Wealth Management. Respondent provided this service with his tax planning "hat" on, not his investment advisor hat.

There is no evidence that Respondent was paid to provide investment advice in this transaction. Absent evidence that Respondent received compensation in return for providing investment advice to investors, he was not acting as an investment adviser within the meaning of the IAA. *See Luzerne Cnty. Ret. Bd. v. Makowski*, 627 F. Supp. 2d 506, 573 (M.D. Pa. 2007).

Instead, Respondent acted as an accountant by trying to help his clients lawfully reduce their tax liabilities. The definitions section of the IAA specifically creates an exception to the "investment adviser" definition for "any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession." 15 U.S.C. 80b-2(11). *See Abrahamson v. Fleschner,* C.A.2 (N.Y.) 1977, 568 F.2d 862, *certiorari denied* 98 S.Ct. 2236, 436 U.S. 905, 56 L.Ed.2d 403, *certiorari denied* 98 S.Ct. 2253, 436 U.S. 913, 56 L.Ed.2d 414*; see also Kaufman*, 464 F. Supp. at 537.

During the FC 2012 transaction, Respondent acted as a CPA, researching and preparing a tax planning transaction, putting him squarely within the accountant exception. Respondent concedes that his work performed under Lloyd Wealth Management is not "solely incidental to the practice of his profession" as a CPA; to argue anything to the contrary would be illogical. However, the FC 2012 transaction was not performed under Lloyd Wealth Management; it was done under Ed Lloyd & Associates, PLLC. The conservation easement transaction was a tax planning

technique which was evaluated as such and did indeed provide tax savings for Respondent's tax clients, and ALJ Foelak determined that it did not involve the purchase or sale of a security. That four of Respondent's clients also happened to be advisory clients does not change the nature of the transaction for them, or any of the other clients. Thus, even if Respondent was deemed to be an "investment adviser" for purposes of the Act, the accountant's exception applies because the work was solely incidental to the provision of tax planning services. Simply put, there was no "investment" on which to advise. Respondent was not subject to the IAA and therefore could not commit a primary violation of Section 206(4).

The Division was required to establish by more than conclusory allegations that Respondent was an investment adviser, and it failed to do so. *Polera v. Altorfer, Podesta, Woolard and Co.*, 503 F. Supp. 116, 119 (N.D. Ill. 1980). The ID's holding that Respondent was an investment adviser and that he committed a primary violation of Section 206(4) of the IAA was erroneous.

C. RESPONDENT REQUESTS REVERSAL OF THE FINDINGS OF VIOLATION OF THE INVESTMENT ADVISORS ACT BECAUSE OF DUE PROCESS VIOLATIONS OCCURRING IN THIS MATTER.

ALJ Elliot's bias in favor of the Division was evident from the first day of the hearing, and it continued each and every day, until the issuance of the ID. From refusing to allow Respondent's expert to testify, to allowing the Division to examine on wholly irrelevant issues, to allowing the Division to repeatedly examine with questions assuming facts not only not in evidence, but contradicted by all evidence, to allowing retrial of issues decided by ALJ Foelak, to sustaining practically every objection the Division made and overruling almost all of Respondent's, to overt statements made

about Respondent, ALJ Elliot's bias permeated throughout the courtroom. In short, the Hearing was quite obviously one-sided. Respondent was deprived of a neutral and disinterested finder of fact and judge of the law,

Although this action has the potential to inflict serious financial and professional consequences, it is labeled a "civil proceeding" taking place in an administrative setting, without the benefit of a neutral and disinterested fact finder, the Federal Rules of Evidence, discovery, or other safeguards. Because ALJs are employees of the Commission, there are significant issues of due process, including the basic tenets of a fair trial and the likelihood of bias, which were evident in the Hearing. Due process not only requires actual fairness but also the appearance of fairness. *See In re Murchison*, 349 U.S. 133, 136, 75 S. Ct. 623, 625, 99 L. Ed. 942 (1955) ("A fair trial in a fair tribunal is a basic requirement of due process. Fairness of course requires an absence of actual bias in the trial of cases. . . . '[J]ustice must satisfy the appearance of justice'"); *see also Amos Treat & Co. Inc. v. SEC*, 306 F.2d 260, 267 (D.C. Cir. 1962) ("[A]n administrative hearing of such importance and vast potential consequences must be attended, not only with every element of fairness but with the very appearance of complete fairness").

Although administrative proceedings are not a per se violation of due process, that does not exclude them from scrutiny. *See Kinsella v. Bd. of Ed. of Cent. Sch. Dist. No. 7 of Towns of Amherst & Tonawanda, Erie Cnty.,* 378 F. Supp. 54, 60 (W.D.N.Y. 1974) (citing *Richardson v. Perales*, 402 U.S. 389, 410, 91 S.Ct. 1420, 28 L.Ed.2d 842 (1971); *Marcello v. Bonds*, 349 U.S. 302, 75 S.Ct. 757, 99 L.Ed. 1107 (1965)). The due process clause itself does not require "proof of actual bias" but instead relies on a

"realistic appraisal of psychological tendencies and human weakness." *See Caperton v. A.T. Massey Coal Co.,* 556 U.S. 868, 883, 129 S. Ct. 2252, 2263, 173 L. Ed. 2d 1208 (2009).

"The right to present evidence is, of course, essential to the fair hearing required by the Due Process Clause." *Jenkins v. McKeithen*, 395 U.S. 411, 424 (1969). At the Hearing, the ALJ consistently favored the position of the Division. Respondent's counsel made various objections to the admission of evidence on the basis that it was irrelevant or prejudicial to the inquiry. (Zak 99:15-25; 100:24-101:4; 101:57-102:9; 107:1-17:13; 109:1-10; 119:9-14; 126:11-127:7; 132:6-15; 133:20-139:23; 188:18-189:9; 197:14-24; 261:2-17; Detheflsen 299:25-304:8, 311:15-312:5; 312:8-314:2; 317:7-14; 318:25-319:5; 330:5-331:2; Seiden 351:8-351:14; Hardin 443:21-445:12; 460:10-15; 463:1-10; 466:3-9; 469:9-18; 472:11-17; 486:23-487:12; 494:2-494:8; 523:17-525:4; Sywak 529:13-25; 531:7-14; Adams 583:1-24; 584:1-7; 611:20-24; Powell 631: 21-25; 637:5-638:4; 650:13-22; 655:21-25; 656:7-12; 660:17-25; Powell 662:4-11; 662:18-24; 665:6-13; 665:25-666:8; 666:23-667:4; 668:1-22; 670:1-16; Lloyd 713:3-16; 719:6-9; 735:15-736:3; 738:16-22; 760:18-22; 771:4-8; 912:19-25; 913:6-12; 914:13-18; 919:10-19; 922:2-10; Losby 939:14-20; 940:10-16; Brown 971:25-975:11; 983:12-22; 985:9-986:3; 986:15-20; 988:13-17; 989:19-22; 991:16-23; Lloyd 997:22-998:5; 1010:24-1011:3; 1011:23-1012:3; 1013:8-16; 1016:23-1017:5; 1021:22-1022:6; 1032:8-14; Hooks 1065:12-16; 1069:16-20; 1070:13-24; 1075:1-8; 1076:7-14; Branch 1099:1-8; Price 1115:6-10; 1149:5-11.) These objections ranged from objections to testimony by counsel for the Division to the use of the word "security" throughout the proceeding, even though ALJ Foelak had come to the conclusion in a prior order that a

security was not at issue. (*See* Admin. Proc. Rulings Release No. 2366.) Furthermore, statements made by ALJ Elliot, on the record, regarding the Respondent are clear evidence of his bias. For example, very early during Respondent's testimony, ALJ Elliot made the following statement: "Well, you know, I have got to say I'm not impressed by Mr. Lloyd so far." (*See* Tr. 713:9-10; *see also* Tr. 697:1-14; 713:9-15; 723:14-724:13; 815:15-823:23.) Simply put, Respondent was denied a neutral and disinterested fact finder.

Perhaps the most obvious basis for reversal is located on pages 31-32 of the ID. After declining to reverse the summary disposition ruling and construe FC 2012 as a security, as requested by the Division, ALJ Elliot went on to state that if the ruling were reversed, the record would likely support violations under the Securities and Exchange Acts. Not only did he make that irrelevant, inappropriate statement, but he also analyzed the facts that would allegedly support such violations. There was absolutely no reason for ALJ Elliot to delve into yet another hypothetical situation and imply that if it had not been for ALK Foelak, he would have thrown the proverbial book at Respondent. Respondent made, and ALJ Foelak granted in part a motion for summary disposition in which it was determined that the various LLC interests offered were not "securities." Respondent appropriately relied on that determination in limiting the presentation of evidence to issues surrounding the alleged violations of the Investment Advisors Act. To allow the Division to retry the underlying determination was clearly a due process violation, to allow the division to characterize the interests as "securities," and to, within the Initial Decision itself to find the interests to be offered under Regulation D, and to

find respondents conduct to threaten "compliance" efforts of others, was a denial of due process.

ALJ Elliot's bias against the Respondent was palpable at the hearing, and it is evident in the ID as well. The proceeding violated Respondent's due process rights, and the appropriate remedy is a reversal of the findings of a violation of the Investment Advisors Act, and of the sanctions assessed.

D. RESPONDENT REQUESTS CORRECTION OF ERRORS IN THE IMPOSITION OF SANCTIONS.

Even if the findings regarding Respondent's status as an investment adviser and the findings regarding the violations of Section 206(4) of the IAA were not in error, the sanctions imposed on Respondent were nevertheless erroneous.

1. A Cease-and-Desist Order was inappropriate.

The finding that a cease-and-desist order was warranted was erroneous because the need for same is moot. Respondent is no longer an associated person of an investment adviser, and all of his securities licenses have since expired. In the alternative, the language of the order is overly broad and puts Respondent at risk for contempt for acts that are unrelated to the alleged harm to be prevented and/or deterred.

Respondent resigned as a registered representative of LPL Financial in March 2013. He has not been associated with any broker-dealer since that time, and as a result, all of his securities licenses have expired. Thus, the entry of a cease-and-desist order was unnecessary because the issue is moot. As the ID pointed out on page 34,

Respondent, quite literally, cannot violate the IAA because he is no longer an associated person of an investment adviser.

In the alternative, the language of the cease-and-desist order is overly broad. The ID prevents Respondent from "committing any violations or future violations of [IAA] Section 206." (*See* ID at 37.) This order is entirely too broad and puts Respondent at risk for contempt for acts that are not related to the alleged harm to be prevented and/or deterred.

A cease-and-desist order is akin to an injunction because both seek to restrain future activity. "Rule 65(d) of the Federal Rules of Civil Procedure provides: 'Every order granting an injunction . . . shall be specific in terms and shall describe in reasonable detail, and not by reference to the complaint or other document, the act or acts sought to be restrained . . . .'" *S.E.C. v. Washington Inv. Network*, 475 F.3d 392, 398 (D.C. Cir. 2007). An order that simply references "future violations" of certain sections of the IAA "fails to clarify 'the act or acts sought to be restrained.'" *Id.* In practice, this broad language "might subject defendants to contempt for activities having no resemblance to the activities that led to the injunction" making it "overly broad in its reach." *Id.* The order enjoins Respondent from committing *any* violations of Rule 206 (1), (2), and (4), though he was only found to have violated section (4). This subjects Respondent to contempt for actions that could in no way relate to the conduct at issue in the FC 2012 transaction. Should a different type of violation of Rule 206 occur in the future, that should be handled via a new, separate OIP. It is entirely too broad to say that *any* possible violation of these sections should result in contempt, especially when

dealing with rules that are all-encompassing themselves. Thus, the cease-and-desist order against all future violations of Sections 206(1), (2), and (4) is erroneous.

2. An associational bar was inappropriate.

The imposition of an associational bar is entirely excessive, inappropriate, and erroneous. Given that none of Respondent's clients were harmed, that the hypothetical "compliance" issues created for SFA and PCH were just that, hypothetical, and that Respondent is no longer licensed to work in the securities industry, an associational bar is erroneous.

An associational bar only serves to punish Respondent in the public eye and will follow him professionally for the rest of his career. Respondent is no longer licensed to work in the securities industry. It is illogical to now implement such a harsh penalty when no clients were harmed and the risk of future violations is practically nihil given Respondent's expired licenses.

3. The calculation of disgorgement was erroneous.

The calculation of the amount of disgorgement was erroneous. In the ID, the ALJ found that Respondent was enriched to the tune of $105,750.00 as a result of his deceit of SFA. The ALJ reasoned that Respondent's "own testimony establishes that, but for his deceit of SFA, his clients could not have participated in FC 2012 and he would not have been entitled to his fees." (*See* ID at 35.)

The argument made by the ALJ in the ID incorrectly assumes that the FC 2012 transaction with PCH would have failed had SFA known that Carson, Brown, and Malloy were members of FC 2012, LLC and therefore participating in the purchase of interests in PCH. The testimony cited in the ID does not support this proposition in any way, and

it contradicts the evidence and testimony presented to hold that *none* of Respondent's clients could have participated in the PCH transaction without the inclusion of Carson, Brown, and Malloy.

There was simply no evidence adduced that warrants the conclusion that *none* of Respondent's clients would have been allowed to contribute. As Respondent testified, one option was to reduce the total participation of FC 2012 in PCH; have the money that was wired returned (consistent with testimony of PCH's attorney); return Carson, Brown, and Malloy's funds to them; and simply participate in a lesser amount with money received from the 15 participants. Respondent would still have received fees from the other 15 participants. Only Carson, Brown, and Malloy would have been barred from participating, and Respondent would have forgone only their fees, which totaled $20,500. (*See* Division Ex. 187.) It is completely erroneous and contradicts the evidence and testimony presented at the Hearing to hold that *none* of Respondent's clients could have participated in the PCH transaction but for his deceit of SFA. Thus, the disgorgement calculation is erroneous. Any disgorgement should be limited to $20,500.

4. The civil penalty assessed was excessive and unsupported by the evidence.

The ID bafflingly states that even though there was no harm to Respondent's clients, and even though the PCH interests were not securities, Respondent "created a risk that [SFA and PCH] would violate the securities laws." (*See* ID at 36.) The ALJ also noted that Respondent received "substantial," unjust fees. *Id.* The $100,000.00 civil penalty is both absurdly high and inaccurately calculated.

The ID provides no support for the proposition that Respondent created a risk that SFA and PCH would violate the securities laws, especially since there was no security. The compliance process for securities transactions is entirely irrelevant because *there was no security*, and basing the civil penalty off of such an irrelevant, hypothetical risk is erroneous.

In addition, once again, the ALJ based his justification for the $100,000.00 civil penalty on the fees received from all 18 clients, not the three at issue. If anything, respondent only gained $20,500.00 from the PCH transaction, not $105,750.00.

Moreover, the ID indicates a $50,000 penalty was assessed for "each of [Respondent's] fraudulent misrepresentations." (*See* ID at 36.) However, Respondent admitted that his failure to include Brown and Malloy as participants in FC 2012 was a mistake on his part (Tr. 880-881); it was not purposefully deceitful or manipulative, and the Division did not prove otherwise. As the ID explained, a second-tier penalty is only permissible "where the respondent's unlawful act or omission involves fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement." (*See* ID at 35.) Respondent's *mistake* does not rise to this level, and the imposition of a second tier penalty for the failure to list Brown and Malloy as participants is erroneous. Should any penalty be appropriate for this mistake, it should be a tier one penalty, which is limited to $5,000 for a natural person. *See* 15 U.S.C. § 80b-3(i)(2)(A).

Given that no participant lost any money, that they were all entitled to the tax deductions they received by virtue of their membership in FC 2012, LLC, and that Respondent is no longer working in the securities industry, any civil penalty assessed should be minimal, and it certainly should not be as excessive as the ID ordered. *See*

S.E.C. v. Bolla, 401 F.Supp.2d 43 (2005) (holding that the requested fines were excessive because no investor lost any money, and the defendant was no longer associated with the investment adviser.)

For these reasons, the $100,000.00 civil penalty is calculated incorrectly, excessive, and therefore erroneous.

III. CONCLUSION

For the reasons stated above, Respondent respectfully requests that the ALJ correct the preceding matters in Initial Decision ("ID") of July 27, 2015, as amended by the ALJ's Order of August 18, 2015.

This 5th day of January, 2018.

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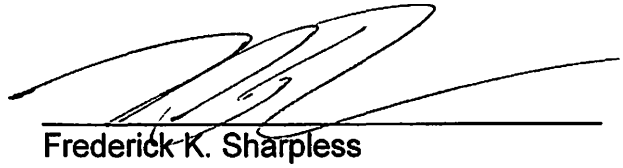
CERTIFICATE OF COMPLIANCE

The signature of respondent's attorney below certifies that, in compliance with the requirements of Securities Exchange Commission Rule 154(c), the word count for the **RESPONDENT'S RESPONSE TO ORDER SCHEDULING SUBMISSION OF NEW EVIDENCE, AND BRIEF IDENTIFYING CHALLENGE RULINGS, FINDINGS OR CONCLUSIONS** filed with the Securities and Exchange Commission on January 4, 2018, contains a total of 6957 words, as reported by the word processing program used to prepare the respondent's response and brief.

This the 5th day of January, 2018.



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CERTIFICATE OF SERVICE

I certify that the **RESPONDENT'S RESPONSE TO ORDER SCHEDULING SUBMISSION OF NEW EVIDENCE, AND BRIEF IDENTIFYING CHALLENGED RULINGS, FINDINGS OR CONCLUSIONS** was served upon the parties to this action by emailing and mailing a copy thereof by first-class, postage pre-paid mail to the following counsel of record:

Honorable Cameron Elliot
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I further certify that the **RESPONDENT'S RESPONSE TO ORDER SCHEDULING SUBMISSION OF NEW EVIDENCE, AND BRIEF IDENTIFYING CHALLENGED RULINGS, FINDINGS OR CONCLUSIONS** was served via facsimile and US Mail upon:

Mr. Brent J. Fields (Original and 3 copies)
Secretary of Commission
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This the 5TH day of January, 2018.

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