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

11  
12  
13 SECURITIES AND EXCHANGE  
COMMISSION,

14 Plaintiff,

15 vs.

16  
17 CRAIG RUMBAUGH,  
RUMBAUGH FINANCIAL, INC,  
18 AND DESERT STRATEGIC  
EQUITY, LLC,

19 Defendants.  
20

Case No. 5:19-cv-01517

**COMPLAINT**

21  
22 Plaintiff Securities and Exchange Commission (“SEC”) alleges:

23 **JURISDICTION AND VENUE**

24 1. The Court has jurisdiction over this action pursuant to Sections 20(b),  
25 20(d)(1) and 22(a) of the Securities Act of 1933 (“Securities Act”), 15 U.S.C. §§  
26 77t(b), 77t(d)(1) & 77v(a), Sections 21(d)(1), 21(d)(3)(A), 21(e) and 27(a) of the  
27 Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. §§ 78u(d)(1),  
28 78u(d)(3)(A), 78u(e) & 78aa(a), and Sections 209(d), 209(e)(1) and 214 of the

1 Investment Advisers Act of 1940 (“Advisers Act”), 15 U.S.C. §§ 80b-9(d), 80b-  
2 9(e)(1) & 90b-14.

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

7 3. Venue is proper in this district pursuant to Section 22(a) of the Securities  
8 Act, 15 U.S.C. § 77v(a), Section 27(a) of the Exchange Act, 15 U.S.C. § 78aa(a), and  
9 Section 214 of the Advisers Act, 15 U.S.C. § 90b-14, because certain of the  
10 transactions, acts, practices and courses of conduct constituting violations of the  
11 federal securities laws occurred within this district. In addition, venue is proper in  
12 this district because Defendants reside in this district.

13 **SUMMARY**

14 4. Defendant Craig C. Rumbaugh (“Rumbaugh”), and two companies he  
15 owns and controls, defendant Rumbaugh Financial Inc. (“RFI”), a California-  
16 registered investment adviser, and defendant Desert Strategic Equity (“DSE”)  
17 (collectively, “Defendants”), defrauded RFI’s advisory clients by misleading them  
18 about the terms of their investments, while hiding Defendants’ self-dealing and  
19 receipt of commissions in connection with those investments. In doing so,  
20 Rumbaugh and RFI offered and sold securities in unregistered offerings, and, with  
21 DSE’s substantial assistance, also acted as unregistered broker-dealers.

22 5. Rumbaugh advised clients to invest in promissory notes offered by  
23 Susan Werth, whose fraudulent offering was the subject of an emergency, civil  
24 injunctive action brought by the SEC against Werth and her companies in 2018—and  
25 a criminal action where she has pled guilty to wire fraud and other charges. From  
26 August 2015 to June 2016, Rumbaugh persuaded eight clients to invest a total of over  
27 \$3 million with Werth’s companies, three of whom lost a total of more than \$600,000  
28 when her Ponzi scheme failed. Werth paid Rumbaugh 5% commissions on all funds

1 raised from his clients, totaling more than \$140,000 in commissions paid during that  
2 period.

3 6. Defendants concealed these commissions from their clients when  
4 recommending investments with Werth's companies. Many times, they also misled  
5 clients about the interest rates Werth's companies were willing to pay, claiming that  
6 the companies offered rates in the 5% to 10% range when, in fact, they offered 30%  
7 interest or more. In those instances, when Werth's companies repaid investor funds  
8 in full at the true, higher interest rates, the Defendants repaid RFI's clients at the  
9 lower rates, secretly pocketing the difference for themselves.

10 7. Through this conduct, Rumbaugh and RFI violated the antifraud  
11 provisions of the Advisers Act, the Securities Act, and the Exchange Act, as well as  
12 Sections 5(a) and (c) of the Securities Act and Section 15(a) of the Exchange Act.  
13 DSE violated the antifraud provisions of the Securities Act and the Exchange Act and  
14 aided and abetted Rumbaugh's and RFI's violations of the Advisers Act and Section  
15 15(a) of the Exchange Act.

16 8. The SEC seeks permanent injunctions, disgorgement with prejudgment  
17 interest, and civil penalties against Defendants.

18 **THE DEFENDANTS**

19 9. Defendant Craig Rumbaugh ("Rumbaugh"), age 49, resides in Indian  
20 Wells, California. He holds a Series 66 license and previously held a Series 7 FINRA  
21 qualification. He is not registered with the Commission. Rumbaugh founded RFI  
22 and DSE, and is their sole owner and operator.

23 10. Defendant Rumbaugh Financial Inc. ("RFI") is a California corporation  
24 organized on July 11, 2013, with its principal place of business in Palm Desert,  
25 California. RFI has been registered as an investment adviser with the State of  
26 California since September 27, 2013. During the relevant period, RFI had  
27 approximately twenty clients and approximately \$1 million in assets under  
28 management.

1 11. Defendant Desert Strategic Equity LLC (“DSE”) is a California  
2 corporation organized on May 31, 2007, with its principal place of business in Palm  
3 Desert, California. It is not registered with the Commission.

4 **RELATED INDIVIDUALS AND ENTITIES**

5 12. From 2015 to 2018, Susan Werth (“Werth”) operated a Ponzi-like  
6 offering fraud through three companies under her control: Corporate Mystic LLC,  
7 Commercial Exchange Solutions Inc., and Exchange Solutions Company. The SEC  
8 filed an injunctive action against Werth and those companies on October 2, 2018 and  
9 obtained a temporary restraining order and a preliminary injunction shortly thereafter.  
10 *SEC v. Susan Werth, et al.*, Case No 2:18-cv-08436-SVW-JPR (C.D. Cal.).  
11 Thereafter, on December 20, 2018, the district court entered a consent judgment  
12 against Werth and her companies, permanently restraining and enjoining them from  
13 violating Sections 5(a), 5(c), and 17(a) of the Securities Act and Section 10(b) of the  
14 Exchange Act.

15 13. In October 2018, the United States Department of Justice returned a  
16 felony indictment against Werth, charging her with wire fraud and aggravated  
17 identity theft. *United States v. Werth*, Case No. 18CR00212-JVS (C.D. Cal.). Werth  
18 pled guilty to one count of wire fraud on May 2, 2019. She is scheduled to be  
19 sentenced on October 28, 2019.

20 14. A special-needs trust (the “Special Needs Trust of Beneficiary A” or the  
21 “Beneficiary A Trust”), governed by California law, was established on May 6, 2014  
22 for the sole benefit of a beneficiary (“Beneficiary A”), who was a client of RFI from  
23 early 2014 until at least March of 2019. Beneficiary A has a serious medical  
24 condition and requires government-sponsored assistance to pay for medications that  
25 he expects to need for the rest of his life. He established the Beneficiary A Trust after  
26 inheriting approximately \$1 million in late 2013 so that the trust could hold those  
27 assets and he would not lose his eligibility for that means-tested assistance. He hired  
28 RFI as his financial advisor shortly thereafter; appointed Rumbaugh as trustee of the

1 Beneficiary A Trust, and gave Rumbaugh, in his capacity as the owner and operator  
2 of RFI, full discretion to manage and invest the its assets.

3 **THE ALLEGATIONS**

4 **A. RFI's Services and Clients**

5 15. RFI provides a combination of financial planning and investment adviser  
6 services to its clients, all of which Rumbaugh handles personally. During the  
7 relevant period, RFI's financial planning services included assisting clients with  
8 estate planning, debt management, and decisions about significant expenditures, such  
9 as homes and automobiles. Its investment adviser services included making  
10 recommendations to clients about asset allocation and potential investments,  
11 including investments in annuities, bonds and securities. These investments included  
12 the promissory notes offered by Werth's companies.

13 16. During the relevant period, RFI typically charged each client a flat fee  
14 for financial services, ranging from \$500 per year to \$15,000 per year, and a  
15 percentage of assets under management for investment adviser services.

16 17. In addition to paying a \$15,000 annual fee, the Beneficiary A Trust paid  
17 RFI an annual "trustee fee" equal to 0.75% of the trust's assets.

18 18. During the relevant period, many of RFI's clients were financially  
19 unsophisticated retirees who were not accredited investors.

20 19. In addition to the approximately \$1 million in assets that RFI and  
21 Rumbaugh managed for the Beneficiary A Trust, Rumbaugh periodically  
22 recommended investments to RFI's other clients, including investments with Werth's  
23 companies.

24 **B. Werth's Fraudulent Scheme**

25 20. From 2015 to 2018, Werth marketed herself and her companies to  
26 investors and prospective investors as facilitators of alleged Internal Revenue Code  
27 Section 1031 exchanges in which Werth's clients sought to defer tax payments on the  
28 sale of real property by re-investing the proceeds of a sale in similar properties within

1 a specified time period. Werth told investors and prospective investors that  
2 participants in Section 1031 exchanges sometimes need cash on short notice to  
3 address unforeseen problems with construction projects on newly purchased  
4 properties, and are willing to pay high interest rates for short-term loans to finish the  
5 projects on time. She claimed to pool investor funds together in order to make short-  
6 term, high-interest loans to her Section 1031 exchange clients, and to pay returns to  
7 investors with the profits generated from those loans. In fact, her clients and the  
8 purported exchanges were fictitious, and Werth misappropriated investor funds for  
9 personal expenses and to make Ponzi-like payments to earlier investors.

### 10 **C. The Promissory Notes**

11 21. Werth raised money from investors by offering them securities in the  
12 form of promissory notes issued by her companies (the “Promissory Notes”). The  
13 Promissory Notes typically came due in 30 days, 45 days, or a similarly short time  
14 period, and always had high interest rates, typically ranging from 15% to 40% over  
15 the short duration of each note. Typically, the notes were freely assignable to other  
16 investors, but not by Werth’s companies. Werth described the Promissory Notes to  
17 potential investors as “Private Investment Transactions” in projects related to Section  
18 1031 exchanges and purportedly used the money from investors to make and service  
19 loans to persons or entities engaging in those exchanges. Typically, Werth’s  
20 investors expected their investments to be pooled with other investor funds for a  
21 specified Section 1031 exchange.

22 22. Werth and her companies raised over \$26 million from at least 17  
23 investors during the course of her fraudulent scheme. They offered their investments  
24 to the general public, including over the Internet and through selling agents, and sold  
25 the investments in multiple states to investors with whom Werth and her companies  
26 had no pre-existing relationship, including clients of RFI residing in California and  
27 Arizona. During the course of those sales, Werth and her selling agents did not take  
28 steps to ensure that investors were accredited, and Werth sold securities to at least

1 some unaccredited investors, including some of RFI's clients.

2 23. Werth's companies never registered any of the Promissory Notes with  
3 the SEC.

4 **D. Rumbaugh's Agreement with Werth to Offer and Sell Unregistered**  
5 **Securities**

6 24. In mid-2015, Werth approached Rumbaugh in an effort to raise investor  
7 funds from RFI's clients.

8 25. She explained her purported Section 1031 business to Rumbaugh,  
9 including her ostensible need to raise money from investors on a short-term, high-  
10 interest basis to lend to her Section 1031 clients. She explained that she and her  
11 companies made money from those investments by collecting fees from her Section  
12 1031 clients and by receiving a percentage of the amounts paid back by those clients  
13 on their high-interest loans.

14 26. Werth claimed to have multiple Section 1031 clients who needed loans;  
15 offered to pay Rumbaugh's clients high returns in short periods of time through the  
16 Promissory Notes; and offered to pay Rumbaugh a commission on any funds his  
17 clients invested.

18 27. Rumbaugh agreed to participate in the offering and selling of Werth's  
19 Promissory Notes.

20 28. Rumbaugh proposed that he receive a 5% commission on his clients'  
21 investments, and Werth agreed.

22 **E. RFI's Clients' Direct Investments with Werth's Companies**

23 29. In August and September of 2015, Rumbaugh helped Werth raise a total  
24 of \$790,000 from RFI's clients through five investments.

25 30. Werth paid a 5% commission to DSE for each of those investments.

26 **1. The Beneficiary A Trust's Investments with Werth's**  
27 **Companies**

28 31. In mid-August 2015, Rumbaugh caused the Beneficiary A Trust to

1 invest \$100,000 in one of Werth's putative exchanges through a Promissory Note  
2 issued to the Beneficiary A Trust by one of Werth's companies.

3 32. The note, which Rumbaugh signed as trustee of the Beneficiary A Trust,  
4 provided that Werth's company would repay the Beneficiary A Trust \$100,000 in  
5 principal with 30% interest in thirty days. The note described the Beneficiary A  
6 Trust as the "Investor" and described Werth's company as the "Investee."

7 33. Thirty days later, Werth's company repaid the Beneficiary A Trust  
8 \$100,000 in principal and \$30,000 in interest.

9 34. Shortly thereafter, Rumbaugh caused the Beneficiary A Trust to invest  
10 another \$140,000 through a Promissory Note issued by another one of Werth's  
11 companies.

12 35. Rumbaugh signed the note in his capacity as trustee, and Werth's  
13 company promised to repay the Beneficiary A Trust \$140,000 in principal with 30%  
14 interest in thirty days.

15 36. One month later, Werth's company repaid the \$140,000 in principal with  
16 \$42,000 in interest.

17 37. Rumbaugh made both of these investments unilaterally, without  
18 explaining them to Beneficiary A.

## 19 **2. Other RFI Clients' Investments with Werth's Companies**

20 38. In September 2015, Rumbaugh recommended the Promissory Notes,  
21 which he described as "investments" with Werth's companies, to three other RFI  
22 clients.

23 39. Rumbaugh verbally discussed the proposed investments with each of  
24 those clients, including the interest rates and other terms; explained the Section 1031  
25 process as Werth had explained it to him; and described the investments as safe  
26 opportunities to make high returns in a short time period.

27 40. Each of those clients signed a thirty-day Promissory Note with one of  
28 Werth's companies that provided for the repayment of principal with 30% interest.



1 41. Rumbaugh facilitated the three investors' investments through in-person  
2 meetings and telephone calls.

3 42. Rumbaugh sent his clients wire transfer instructions via email, which  
4 clients used to transfer funds directly to Werth's companies.

5 43. Rumbaugh insisted to investors that all communications concerning the  
6 proposed transactions go through him, rather than Werth.

7 44. One month later, Werth repaid all three investors with the promised  
8 interest.

9 **F. The DSE Transactions**

10 45. After September 2015, Werth continued to seek investments from  
11 Rumbaugh for his clients to invest on the same and similar terms; however, starting  
12 in October 2015, Rumbaugh had his clients invest through DSE, rather than directly  
13 with Werth, so that he, RFI, and DSE could profit from the investments without his  
14 clients' knowledge (the "DSE Transactions").

15 **1. Additional Investments by the Beneficiary A Trust**

16 46. In early October 2015, Werth offered to pay 30% interest on a thirty-day  
17 Promissory Note concerning a purported Section 1031 exchange, and Rumbaugh  
18 caused the Beneficiary A Trust to invest \$200,000 in that note.

19 47. Instead of transferring the funds directly from the trust to one of Werth's  
20 companies and signing a Promissory Note in which the trust was the "investor" in the  
21 note, Rumbaugh transferred the trust's funds to DSE; wired those funds from DSE to  
22 one of Werth's companies the next day; and signed a Promissory Note in which  
23 Werth's company promised to pay \$200,000 in principal and 30% interest to DSE in  
24 thirty days.

25 48. One month later, Werth returned \$200,000 in principal with \$60,000 in  
26 interest to DSE, and Rumbaugh used \$210,000 of those funds to repay the  
27 Beneficiary A Trust its principal with 5% interest.

28 49. Rumbaugh kept the remaining 25% in interest paid by Werth, which

1 amounted to \$50,000, for himself, RFI, and DSE.

2 50. Although Rumbaugh had a duty to disclose any conflicts of interest he  
3 had in the trust's investments as Beneficiary A's investment adviser, he did not  
4 disclose the investment or his retention of \$50,000 in profits to Beneficiary A.

5 51. Over the next two months, Rumbaugh caused the Beneficiary A Trust to  
6 invest an additional \$630,000 in four more of Werth's purported Section 1031  
7 exchanges.

8 52. Each time, he wired funds from the trust to DSE; executed a thirty-day  
9 Promissory Note between DSE and one of Werth's companies; and wired the trust's  
10 funds from DSE to Werth's company in order to complete the transaction.

11 53. In one instance, Rumbaugh combined a \$50,000 investment from the  
12 Beneficiary A Trust with a \$100,000 investment from another RFI client to purchase  
13 a \$150,000 Promissory Note.

14 54. In three instances, Rumbaugh combined the trust's investments with a  
15 relatively small amount of his own funds to purchase Promissory Notes in higher  
16 principal amounts, for instance, combining \$190,000 from the trust and \$10,000 of  
17 his own funds to purchase a \$200,000 Promissory Note.

18 55. Rumbaugh did not discuss any of these investments with Beneficiary A  
19 before making the investments.

## 20 **2. Other Clients' Investments through DSE**

21 56. Between August 2016 and June 2016, in addition to investing the  
22 Beneficiary A Trust's assets with Werth's companies, Rumbaugh recommended  
23 Werth's Promissory Notes to a number of RFI's other clients, seven of whom  
24 invested a total of more than \$1.2 million in eight different transactions.

25 57. Two of those investors were family members of Rumbaugh's, who  
26 invested a total of \$275,000 directly with Werth's companies in October 2015 and  
27 received their full principal with interest thereafter.

28 58. For the other five clients, Rumbaugh set up the transactions using DSE,

1 so that DSE would receive the full 35%, 37%, or 40% interest offered under the  
2 Promissory Notes, and RFI's clients would receive a lower interest rate for the same  
3 transactions – either 5%, 10%, or 25% – pursuant to promissory notes issued to those  
4 clients by DSE (the “DSE Notes”).

5 **a. Clients Who Had Previously Invested with Werth**

6 59. Three of those five clients mentioned in paragraph 58 above had  
7 previously invested with Werth's companies based on Rumbaugh's  
8 recommendations, and Rumbaugh presented the new transactions through DSE as  
9 repeats of their earlier investments, just with lower interest rates.

10 60. One of those three clients asked Rumbaugh verbally, in or about late  
11 October 2015 why his second investment would pay 10% interest when his first  
12 investment had paid 30% interest, and Rumbaugh falsely replied that interest rates in  
13 the 30% range had been special opportunities that were no longer available from  
14 Werth's companies.

15 61. Instead of sending their funds directly to Werth's companies and signing  
16 Promissory Notes with those companies, each of these clients signed a thirty-day  
17 promissory note issued by DSE with either a 10% or a 25% interest rate, and wired  
18 their funds to DSE based on Rumbaugh's instructions.

19 62. Those DSE Notes, which Rumbaugh sent to clients and executed on  
20 DSE's behalf, were securities and were nearly identical to the Promissory Notes  
21 offered by Werth's companies, just with DSE as the counterparty (and with lower  
22 interest rates).

23 63. Shortly after signing a DSE Note with a client and receiving the client's  
24 funds for a given transaction, DSE entered into a thirty-day Promissory Note with one  
25 of Werth's companies for the same principal amount (or a higher amount that  
26 combined two client investments into one Promissory Note), but at a higher interest  
27 rate – ranging from 30% to 50% – than DSE had promised to pay the client.

28 64. Rumbaugh then wired the funds to Werth's company.

1           65. Rumbaugh falsely assured each of the investors orally that the  
2 transactions were the same in substance as their previous investments.

3           66. Rumbaugh explicitly – and falsely – told at least one of those clients that  
4 making the investment through DSE, rather than directly with one of Werth’s  
5 companies, made no difference to the investment.

6                   **b. Clients Who Had Not Previously Invested with Werth**

7           67. When recommending Werth’s Promissory Notes to the other two clients  
8 who invested through DSE, neither of whom had previously invested with Werth’s  
9 companies, Rumbaugh explained orally the investments as Werth had explained them  
10 to him, and encouraged the clients to take advantage of the rare opportunity to earn  
11 5% interest in thirty days.

12           68. Based on Rumbaugh’s recommendations, the clients agreed to invest  
13 and, between them, entered into three, thirty-day DSE Notes in which DSE promised  
14 to return their principal with 5% interest.

15           69. Rumbaugh’s clients wired their funds to DSE, and DSE transferred those  
16 funds to one of Werth’s companies the same day.

17           70. In connection with each transaction, DSE entered into an essentially  
18 identical, thirty-day Promissory Note with one of Werth’s companies for the same  
19 principal amount (or a higher amount that combined two client investments into a  
20 single Promissory Note), but with interest rates ranging from 30% to 40%.

21           71. Neither client understood DSE’s role in the transactions, and both  
22 expected their funds to be invested in Werth’s Section 1031 exchanges.

23                   **G. Payments, Profit-Sharing, Delays in Repayment, and Investor**  
24                   **Losses**

25           72. Werth’s companies timely repaid some of the Promissory Notes that  
26 they executed with DSE in full, with the promised interest. In those instances,  
27 Rumbaugh used those funds to pay principal and interest to RFI’s clients at the lower  
28 interest rates included in the DSE Notes and kept the additional interest for himself

1 and his companies.

2 73. Specifically, Werth sent principal and interest to DSE, which returned  
3 principal and some interest to some clients, and then Rumbaugh caused DSE to share  
4 the remaining funds with himself and RFI.

5 74. Starting in late November 2015, Werth's companies failed to repay the  
6 Promissory Notes on time, and DSE did not return principal or interest on those  
7 investments to RFI's clients. Notwithstanding the DSE Notes, Rumbaugh explained  
8 to his clients that they had invested with Werth's companies and would need to wait  
9 for those companies to repay the investments.

10 75. Over the next two years, Werth's companies belatedly repaid some of  
11 the Promissory Notes with a portion of the interest due, and Rumbaugh returned some  
12 principal and some interest to some of RFI's clients.

13 76. Ultimately, however, Werth failed to pay principal and interest on  
14 investments made by three of RFI's clients, and Rumbaugh did not cover the  
15 shortfall. Those clients lost their full principal and received no interest on a total of  
16 three investments, and one suffered a partial loss of principal – and received no  
17 interest – on a fourth investment.

18 77. In total, those RFI clients lost approximately \$640,000 in principal, and  
19 all were net losers from investing with Werth's companies, even after accounting for  
20 previous transactions in which principal had been returned and interest paid.

21 **J. Rumbaugh and RFI Acted as Investment Advisers**

22 78. At all relevant times, both Rumbaugh and RFI were investments advisers  
23 within the meaning of Section 202(a)(11) of the Advisers Act as they both, for  
24 compensation, engaged in the business of advising others, either directly or through  
25 publications and writings, as to the value of securities or as to the advisability of  
26 investing in, purchasing or selling securities.

27 79. During the relevant period, RFI was a registered investment adviser with  
28 the State of California and fell within the definition of Section 202(a)(11) of the

1 Advisers Act because, through Rumbaugh's efforts, it provided investment advice to  
2 clients with respect to securities in return for compensation.

3 80. During the relevant period, Rumbaugh was an associated person of RFI  
4 and met the definition of Section 202(a)(11) of the Advisers Act because he owned  
5 and controlled RFI, which provided investment adviser services through Rumbaugh;  
6 personally recommended investments to RFI's clients; and received compensation in  
7 the form of annual fees, the trustee fee, a percentage of the Beneficiary A Trust's  
8 assets under management, commissions and the interest-rate spreads.

9 81. As investment advisers, Rumbaugh and RFI had an affirmative duty of  
10 utmost good faith, to make a full and fair disclosure of all material facts, and to  
11 employ reasonable care to avoid misleading clients.

12 **K. Defendants' Materially Misleading Statements About the DSE**  
13 **Transactions**

14 82. Rumbaugh, RFI, and DSE made misleading statements to RFI's clients  
15 when recommending the DSE Transactions. In each of those transactions,  
16 Rumbaugh, on RFI's and DSE's behalf, represented that Werth's companies were  
17 offering much lower interest rates than they actually were; did not disclose the true  
18 interest rates offered by those companies; and did not tell RFI's clients that  
19 Rumbaugh and his companies planned to keep the difference for themselves.

20 83. When recommending the DSE Transactions to clients who had  
21 previously invested with Werth, Rumbaugh further misrepresented that the  
22 transactions were repeats of those clients' earlier investments, aside from the lower  
23 interest rates, without disclosing that the interest rates were lower because the  
24 Defendants planned to keep most of the investment returns for themselves.

25 84. When recommending the transactions to at least one client, Rumbaugh  
26 falsely stated that Werth's companies no longer offered higher rates for investments  
27 in her Section 1031 exchanges.

28 85. These misleading statements were material to investors because they

1 concerned the most important term of the investments, and because the true interest  
2 rates offered by Werth's companies were a multiple of the interest rates offered in the  
3 DSE Notes.

4 86. The statements were material for the additional reason that they  
5 concealed the Defendants' intent to keep the lion's share of the investment returns for  
6 themselves, which deprived RFI's clients of the opportunity to receive those returns  
7 and concealed a conflict-of-interest in Rumbaugh's recommendations.

8 87. A reasonable investor would have wanted to know the true terms of the  
9 proposed investments and whether or not their investment adviser had a personal  
10 interest in the transactions.

11 **L. Undisclosed Commissions in All of the Werth-Related Transactions**

12 88. When recommending investments with Werth's companies – and  
13 investing the Beneficiary A Trust's funds with those companies – the Defendants also  
14 failed to disclose their 5% commissions, either orally or in writing.

15 89. RFI's clients would have considered it important to know in making  
16 their investment decisions that Werth's companies were offering to pay Rumbaugh a  
17 5% commission on all of his clients' investments.

18 **M. Rumbaugh and RFI Acted Knowingly or, at a Minimum,  
19 Negligently**

20 90. Rumbaugh knew, or was reckless in not knowing, that it was a breach of  
21 his fiduciary duty as an investment adviser to engage in the conduct described above.

22 91. Rumbaugh acted knowingly, or recklessly by making misleading  
23 statements about the interest rates available to RFI's clients from Werth's companies  
24 in the DSE Transactions; and failing to disclose (a) the true, much-higher interest rates  
25 offered by Werth's companies in those transactions; (b) his plan to keep the difference  
26 for himself and RFI; and (c) his receipt of commissions from Werth's companies.

27 92. At a minimum, Rumbaugh acted negligently by falling below the  
28 standard of care expected of an investment adviser by charging and by not disclosing

1 undisclosed and excessive fees. For an investment adviser, the standard of care is  
2 based on its fiduciary duty. As a fiduciary, Rumbaugh owed his clients undivided  
3 loyalty and hence he should not have engaged in activity that conflicted with his  
4 clients' interests.

5 93. Because Rumbaugh owned and controlled RFI, his knowledge,  
6 recklessness and/or negligence can be imputed to RFI.

7 **N. DSE Aided and Abetted Rumbaugh's and RFI's Violations of**  
8 **Sections 206(1) & (2) of the Advisers Act, Section 5 of the Securities**  
9 **Act, and Section 15(a) of the Exchange Act**

10 94. DSE provided substantial assistance to Rumbaugh's and RFI's violations  
11 of Sections 206(1) & (2) of the Advisers Act, Section 5 of the Securities Act, and  
12 Section 15(a) of the Exchange Act, by receiving client funds for investments in the  
13 DSE Transactions; executing the DSE Notes with those clients; wiring investor funds  
14 to Werth's companies in order to purchase Promissory Notes; signing the Promissory  
15 Notes; receiving commissions from Werth's companies; receiving investment returns  
16 from Werth's companies; distributing a portion of those returns to RFI's clients; and  
17 sharing the rest of the investment returns with Rumbaugh and RFI.

18 95. DSE acted knowingly in engaging in this conduct because it acted  
19 entirely through Rumbaugh, its sole owner and operator, whose knowledge and/or  
20 recklessness can be imputed to DSE.

21 **FIRST CLAIM FOR RELIEF**

22 **Fraud by an Investment Adviser**

23 **Violations of Sections 206(1) and 206(2) of the Advisers Act**  
24 **(against Defendants Rumbaugh and RFI; aiding and abetting by DSE)**

25 96. The SEC re-alleges and incorporates by reference paragraphs 1 through  
26 95 of this Complaint as if fully set forth herein.

27 97. Defendants Rumbaugh and RFI, at all relevant times, were investment  
28 advisers within the meaning of Section 202(a)(11) of the Advisers Act [15 U.S.C. §



1 80b-2(a)(11)].

2 98. Among other things, Rumbaugh and RFI made material misstatements  
3 and omissions, and breached their fiduciary duties to their clients, by misrepresenting  
4 the interest rates available to RFI's clients from Werth's companies in the DSE  
5 Transactions; failing to disclose the true, much-higher interest rates offered by  
6 Werth's companies in those transactions; failing to disclose their plan to keep the  
7 difference for themselves; and failing to disclose their receipt of 5% commissions.

8 99. By engaging in the conduct described above, Rumbaugh and RFI, and  
9 each of them, directly or indirectly, by use of the mails or means and instrumentalities  
10 of interstate commerce: (a) knowingly or recklessly employed devices, schemes or  
11 artifices to defraud clients or prospective clients, in violation of Section 206(1) of the  
12 Advisers Act; and (b) knowingly, recklessly or negligently engaged in transactions,  
13 practices, or courses of business which operated as a fraud or deceit upon clients or  
14 prospective clients, in violation of Section 206(2) of the Advisers Act.

15 100. Defendants RFI and DSE acted entirely through Rumbaugh, their sole  
16 owner and operator, whose knowledge, recklessness and/or negligence can be  
17 imputed to RFI and DSE.

18 101. By engaging in the conduct described above, Rumbaugh and RFI, and  
19 each of them, have violated, and unless restrained and enjoined, are reasonably likely  
20 to continue to violate, Sections 206(1) and (2) of the Advisers Act [15 U.S.C. §§ 80b-  
21 6(1) & 80b-6(2)].

22 102. DSE provided substantial assistance to Rumbaugh's and RFI's violations  
23 of the Advisers Act, and unless restrained and enjoined, is reasonably likely to  
24 continue to aid and abet violations of Sections 206(1) and (2) of the Advisers Act [15  
25 U.S.C. §§ 80b-6(1) & 80b-6(2)].



1 artifices to defraud; with scienter or negligence, obtained money or property by  
2 means of untrue statements of a material fact or by omitting to state a material fact  
3 necessary in order to make the statements made, in light of the circumstances under  
4 which they were made, not misleading; and, with scienter or negligence, engaged in  
5 transactions, practices, or courses of business which operated or would operate as a  
6 fraud or deceit upon the purchaser.

7 107. Defendants RFI and DSE acted entirely through Rumbaugh, their  
8 sole owner and operator, whose knowledge, recklessness and/or negligence may be  
9 imputed to RFI and DSE.

10 108. By engaging in the conduct described above, Defendant Rumbaugh, RFI  
11 and DSE violated, and unless restrained and enjoined will continue to violate,  
12 Sections 17(a)(1)-(3) of the Securities Act, 15 U.S.C. §§ 77q(a)(1)-77q(a)(3).

### 13 **THIRD CLAIM FOR RELIEF**

#### 14 **Fraud in Connection with the Purchase or Sale of Securities**

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

#### 16 **(against all Defendants)**

17 109. The SEC re-alleges and incorporates by reference paragraphs 1 through  
18 95 above.

19 110. Among other things, Rumbaugh and RFI engaged in a fraudulent scheme  
20 that included the use of deceptive acts, practices, transactions, devices and courses of  
21 business, including material misstatements and omissions made to RFI's clients, by  
22 misrepresenting the interest rates available to RFI's clients from Werth's companies  
23 in the DSE Transactions; by failing to disclose the true, much-higher interest rates  
24 offered by Werth's companies in those transactions; by failing to disclose their plan  
25 to keep the difference for themselves; by failing to disclose their receipt of 5%  
26 commissions; by engaging in self-dealing in the Beneficiary A Trust's investments  
27 and by secretly keeping profits from those investments; by misappropriating the  
28 proceeds of investments and by hiding that misappropriation using a sham structure

1 that interposed DSE between the investors and Werth, thereby deceiving investors  
2 about the returns of their investments.

3 111. By engaging in the conduct described above, Defendants Rumbaugh,  
4 RFI and DSE, and each of them, directly or indirectly, in connection with the  
5 purchase or sale of a security, and by the use of means or instrumentalities of  
6 interstate commerce, of the mails, or of the facilities of a national securities  
7 exchange: (a) employed devices, schemes, or artifices to defraud; (b) made untrue  
8 statements of a material fact or omitted to state a material fact necessary in order to  
9 make the statements made, in the light of the circumstances under which they were  
10 made, not misleading; and (c) engaged in acts, practices, or courses of business which  
11 operated or would operate as a fraud or deceit upon other persons.

12 112. In engaging in the conduct described above, Defendant Rumbaugh acted  
13 knowingly or recklessly.

14 113. Defendants RFI and DSE acted knowingly or recklessly in engaging in  
15 this conduct because they acted entirely through Rumbaugh, their sole owner and  
16 operator, whose knowledge and recklessness may be imputed to RFI and DSE.

17 114. By engaging in the conduct described above, Defendants Rumbaugh,  
18 RFI and DSE violated, and unless restrained and enjoined will continue to violate,  
19 Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rules 10b-5(a)-(c)  
20 thereunder, 17 C.F.R. §§ 240.10b-5(a)-(c).

21 **FOURTH CLAIM FOR RELIEF**

22 **Unregistered Offer and Sale of Securities**

23 **Violations of Sections 5(a) and 5(c) of the Securities Act**

24 **(against Defendants Rumbaugh and RFI)**

25 115. The SEC re-alleges and incorporates by reference paragraphs 1 through  
26 95 above.

27 116. Rumbaugh and RFI participated in the offer and sale of Werth's  
28 Promissory Notes to RFI's clients. On RFI's behalf, Rumbaugh also discussed the

1 terms of the transactions with RFI's clients, encouraged them to invest, and assisted  
2 them in signing the Promissory Notes. Werth's companies never registered any of  
3 those offerings with the SEC.

4 117. By engaging in the conduct described above, Defendants Rumbaugh and  
5 RFI, and each of them, directly or indirectly, singly and in concert with others, made  
6 use of the means or instruments of transportation or communication in interstate  
7 commerce, or of the mails, to offer to sell or to sell securities, or carried or caused to  
8 be carried through the mails or in interstate commerce, by means or instruments of  
9 transportation, securities for the purpose of sale or for delivery after sale, when no  
10 registration statement had been filed or was in effect as to such securities, and when  
11 no exemption from registration was applicable.

12 118. By engaging in the conduct described above, Defendants Rumbaugh and  
13 RFI have violated, and unless restrained and enjoined, are reasonably likely to  
14 continue to violate, Sections 5(a) and 5(c), 15 U.S.C. §§ 77e(a) & 77e(c).

15 **FIFTH CLAIM FOR RELIEF**

16 **Unregistered Broker-Dealer**

17 **Violation of Section 15(a) of the Exchange Act**

18 **(against Defendants Rumbaugh and RFI; aiding and abetting by DSE)**

19 119. The SEC re-alleges and incorporates by reference paragraphs 1 through  
20 95 above.

21 120. Rumbaugh and RFI effected securities transactions between RFI's  
22 clients and Werth's companies, and between RFI's clients and DSE, as part of their  
23 regular business. From August 2015 through May 2016, Rumbaugh and RFI  
24 facilitated seventeen such investments, totaling over \$3 million, for eight different  
25 investors. Rumbaugh and RFI actively solicited those clients to invest in the  
26 Promissory Notes and the DSE Notes; advised them on the merits of those  
27 investments; received transaction-based compensation in the form of 5%  
28 commissions; facilitated the sale of Promissory Notes for two different issuers

1 associated with Werth, in addition to DSE; required RFI's clients to send documents  
2 and communications about the transactions through Rumbaugh; handled client funds  
3 and securities with respect to the DSE Transactions; and handled client securities  
4 with respect to the Promissory Notes and the DSE Notes in both the DSE  
5 Transactions and RFI's clients' direct investments with Werth's companies.

6 121. By engaging in the conduct described above, Defendant Rumbaugh and  
7 RFI, and each of them, made use of the mails and means or instrumentalities of  
8 interstate commerce to effect transactions in, and induced and attempted to induce the  
9 purchase or sale of, securities (other than exempted securities or commercial paper,  
10 bankers' acceptances, or commercial bills) without being registered with the SEC in  
11 accordance with Section 15(b) of the Exchange Act, 15 U.S.C. § 78o(b), and without  
12 complying with any exemptions promulgated pursuant to Section 15(a)(2), 15 U.S.C.  
13 § 78o(a)(2).

14 122. By engaging in the conduct described above, Defendants Rumbaugh and  
15 RFI have violated, and unless restrained and enjoined, are reasonably likely to  
16 continue to violate, Section 15(a) of the Exchange Act, 15 U.S.C. § 78o(a).

17 123. DSE provided substantial assistance to Rumbaugh's and RFI's violations  
18 of Section 15(a) of the Exchange Act, and unless restrained and enjoined, is  
19 reasonably likely to continue to aid and abet violations of Section 15(a) of the  
20 Exchange Act, 15 U.S.C. § 78o(a).

21 **PRAYER FOR RELIEF**

22 WHEREFORE, the SEC respectfully requests that the Court:

23 **I.**

24 Issue findings of fact and conclusions of law that Defendants committed the  
25 alleged violations.

26 **II.**

27 Issue judgments, in forms consistent with Rule 65(d) of the Federal Rules of  
28 Civil Procedure, permanently enjoining Rumbaugh and RFI, and their officers,

1 agents, servants, employees and attorneys, and those persons in active concert or  
2 participation with any of them, who receive actual notice of the judgment by personal  
3 service or otherwise, and each of them, from violating Sections 206(1) and 206(2) of  
4 the Advisers Act [15 U.S.C. §§ 80b-6(1), 80b-6(2); Section 17(a) of the Securities  
5 Act [15 U.S.C. §77q(a)]; Section 10(b) of the Exchange Act [15 U.S.C. §§ 78j(b)]  
6 and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]; Section 15(a) of the Exchange  
7 Act [15 U.S.C. §§ 78o(a)]; and Sections 5(a) and 5(c) of the Securities Act [15 U.S.C.  
8 §§ 77e(a), 77e(c)].

9 **III.**

10 Issue judgments, in forms consistent with Rule 65(d) of the Federal Rules of  
11 Civil Procedure, permanently enjoining DSE, and its officers, agents, servants,  
12 employees and attorneys, and those persons in active concert or participation with  
13 any of them, who receive actual notice of the judgment by personal service or  
14 otherwise, and each of them, from violating, or aiding and abetting violations of  
15 Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. §§ 80b-6(1) and 80b-6(2);  
16 Section 17(a) of the Securities Act [15 U.S.C. §77q(a)]; Section 10(b) of the  
17 Exchange Act [15 U.S.C. §§ 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-  
18 5]; Section 15(a) of the Exchange Act [15 U.S.C. §§ 78o(a)]; and Sections 5(a) and  
19 5(c) of the Securities Act [15 U.S.C. §§ 77e(a), 77e(c)].

20 **IV.**

21 Order Defendants to disgorge all funds received from their illegal conduct,  
22 together with prejudgment interest thereon.

23 **V.**

24 Order Defendants to pay civil penalties under Section 209(e) of the Advisers  
25 Act [15 U.S.C. § 809-9(e)], Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)]  
26 and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)].

27 **VI.**

28 Retain jurisdiction of this action in accordance with the principles of equity and

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

4 **VII.**

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

7 Dated: August 14, 2019

8  
9 */s/ Donald W. Searles*

10 DONALD W. SEARLES

11 Attorney for Plaintiff

12 Securities and Exchange Commission  
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# Complaints and Other Initiating Documents

[5:19-cv-01517 Securities and Exchange Commission v. Rumbaugh et al](#)

UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA

## Notice of Electronic Filing

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**Case Name:** Securities and Exchange Commission v. Rumbaugh et al

**Case Number:** [5:19-cv-01517](#)

**Filer:** Securities and Exchange Commission

**Document Number:** [1](#)

### Docket Text:

**COMPLAINT No Fee Required - US Government, filed by Plaintiff Securities and Exchange Commission. (Attorney Donald W Searles added to party Securities and Exchange Commission(pty:pla))(Searles, Donald)**

### 5:19-cv-01517 Notice has been electronically mailed to:

Donald W Searles searlesd@sec.gov, irwinma@sec.gov, LAROFiling@sec.gov, longoa@sec.gov, millerdou@sec.gov

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