UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,	)	
PLAINTIFF	)	
v.	)	**Civil Action No.:**
PATRICK O. HOWARD; HOWARD CAPITAL HOLDINGS, LLC; AND OPTIMAL ECONOMICS CAPITAL PARTNERS, LLC,	)	**FILED UNDER SEAL** 3-17CV-420-L
DEFENDANTS.	)	

BRIEF IN SUPPORT OF MOTION FOR PRELIMINARY INJUNCTION, *EX PARTE* TEMPORARY RESTRAINING ORDER, ASSET FREEZE, APPOINTMENT OF A RECEIVER, AND OTHER EMERGENCY AND ANCILLARY RELIEF

Dated: February 14, 2017

Respectfully submitted,

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As reflected in the accompanying evidentiary Appendix[1], Defendants Patrick O. Howard, Howard Capital Holdings, LLC ("Howard Capital"), and Optimal Economics Capital Partners, LLC ("OE Capital") have defrauded investors of at least $13.1 million in fraudulent securities offerings. Plaintiff Securities and Exchange Commission ("SEC" or "Commission") submits this Brief in Support of its Motion for Preliminary Injunction and *Ex Parte* Temporary Restraining Order, Asset Freeze, Appointment of a Receiver, and other Relief to halt ongoing violations of the law and to protect the SEC's ability to recover assets for harmed investors.

I. Summary of Relief Sought

The SEC seeks a preliminary injunction as to the Howard Defendants, pending final judgment, and *ex parte* relief including the following orders against them: (1) temporarily restraining them from engaging in conduct violative of the federal securities laws; (2) freezing their assets; (3) appointing a Receiver to marshal, conserve, and hold the funds, assets, and property subject to their ownership, possession, or control; (4) prohibiting them from moving, altering, or destroying books, records, and accounts; (5), requiring them to provide a sworn, interim accounting to the SEC or, if the Court appoints a Receiver, to the Receiver; and (6) authorizing expedited discovery for the purpose of evidence gathering in advance of any preliminary-injunction hearing.

II. The Parties

A. Plaintiff SEC is an agency of the United States of America charged with enforcing the federal securities laws.

B. Howard, an individual aged 46, resides in Dallas, Texas. App. 346. Howard

[1] The Statement of Fact section, below, reflects page-number citations to the Appendix as required under Local Rule 71(i)(4). For example, the citation "App. 1, 59, 101." refers to pages one, 59, and 101 of the Appendix. For most pages cited, the specific supporting evidence is framed in a box for ease of reference.

owns Howard Capital and OE Capital. App. 5.

C. Howard Capital is a Texas limited liability company, owned by Howard, with its principal place of business in Dallas, Texas. App. 5, 349.

D. OE Capital is a Texas limited liability company, owned by Howard Capital, with its principal place of business in Dallas, Texas. App. 5, 11, 349.

III. Statement of Facts

A. Howard Operated three Funds through Howard Capital and OE Capital

Since March 2015, Howard Capital and OE Capital have raised more than $13 million by selling securities in three Texas limited liability companies: (1) Insured Liquidity Partners CFG I, LLC ("CFG I"), (2) Insured Liquidity Partners CFG II, LLC ("CFG II"), and OE Capital Ventures, LLC ("OE Fund") (collectively, the "Funds"). App. 19, 532, 603, 667, 693, 976. Howard operated each of the three companies as an investment fund. App. 10, 12-15, 550, 623, 705. Investors had no control over the management of the Funds. App. 559, 589, 635, 650, 705, 716, 733-734. They looked to Howard and his companies' management to bring about fund success. *Id.* And their sole contribution to the Funds was that of money. *Id.*

For each fund, the table below sets out the offering period, investor count, and the specific amount raised:

Fund	Offering Period	Investors	Amount Raised
CFG I	March 2015 – January 2016	18	$ 833,993
CFG II	August 2015 – February 2016	36	$ 4,297,398
OE Fund	February 2016 – Present	65	$ 7,960,585
Total:		**119**	**$13,091,976**

App. 976, 982-984, 988.

Howard managed the Funds personally and through Howard Capital and OE Capital. App. 5, 10, 13-15, 50, 103, 105, 550, 636, 976, 982-983, 986. Howard exercised ultimate

authority over Howard Capital, OE Capital, and each of the Funds, including their bank accounts, overall direction, the content of their public statements, and the decision to disseminate such statements. App. 3, 5, 11, 51-54, 111-112, 277 349, 602, 667, 737, 756-763, 846-862.

Through Howard Capital, Howard solicited investors in person and by telephone to raise the money for CFG I. App. 10-11, 19, 103, 108. For CFG II and OE Fund, he solicited investors personally and retained C4 Benefits and Trajan Income to raise money by soliciting investors. App. 17, 19, 105, 284, 301, 863, 870-871. After receiving training from OE Capital, sales agents at these companies raised money for those two Funds through May 2016, in exchange for a 5% sales commission. App. 6, 178, 264-265, 284, 286, 301, 764, 775, 863. Howard and sales agents he employed at OE Capital have also offered OE Fund Units for sale in investor seminars and by email. App. 20, 891-893, 869, 968.

The Funds accepted investments retirement and non-retirement savings. App. 182. OE Capital accepted existing retirement savings by arranging for investors to set up roll-over accounts at a self-directed-IRA company into which retirement funds could be transferred. App. 182, 832, 836.

B. Written Offering Material

In soliciting investors for each of the Funds, Howard distributed a partnership agreement and private-placement memorandum ("PPM"), describing the Fund, its management, and its investment objectives. App. 20, 49, 51-52, 95, 97, 175, 532, 550, 577, 589, 600, 602, 623, 667, 705. Howard personally distributed the CFG I PPM and partnership agreement to investors. App. 51, 108. For the CFG II and OE Fund, he provided PPMs and partnership agreements to C4 Benefits and Trajan Income to disseminate to investors. App. 17, 20, 260. He also provided C4 Benefits and Trajan Income a packet of OE Capital marketing documents (the "Investor

Packet"), which he updated from time to time, for dissemination by C4 Benefits and Trajan Income staff when soliciting investors to purchase Fund Units. App. 53, 111-112, 735-755, 756-763, 846-862. OE Capital employees also disseminated the Investor Packet to investors. App. 892, 911-914.

Although the language varied somewhat among the three PPMs, each one provided that the fund would raise money by selling securities in the form of "membership units" ("Units") in the fund for $50,000 apiece. App. 532, 603, 701. Each PPM provided that the investment had a three-year term and specified the amount the fund sought to raise. App. 561, 637, 704. This amount was $1 million for CFG I and $10 million for CFG II and OE Fund. App. 532, 603, 693.

C. The Funds' Investment Objectives

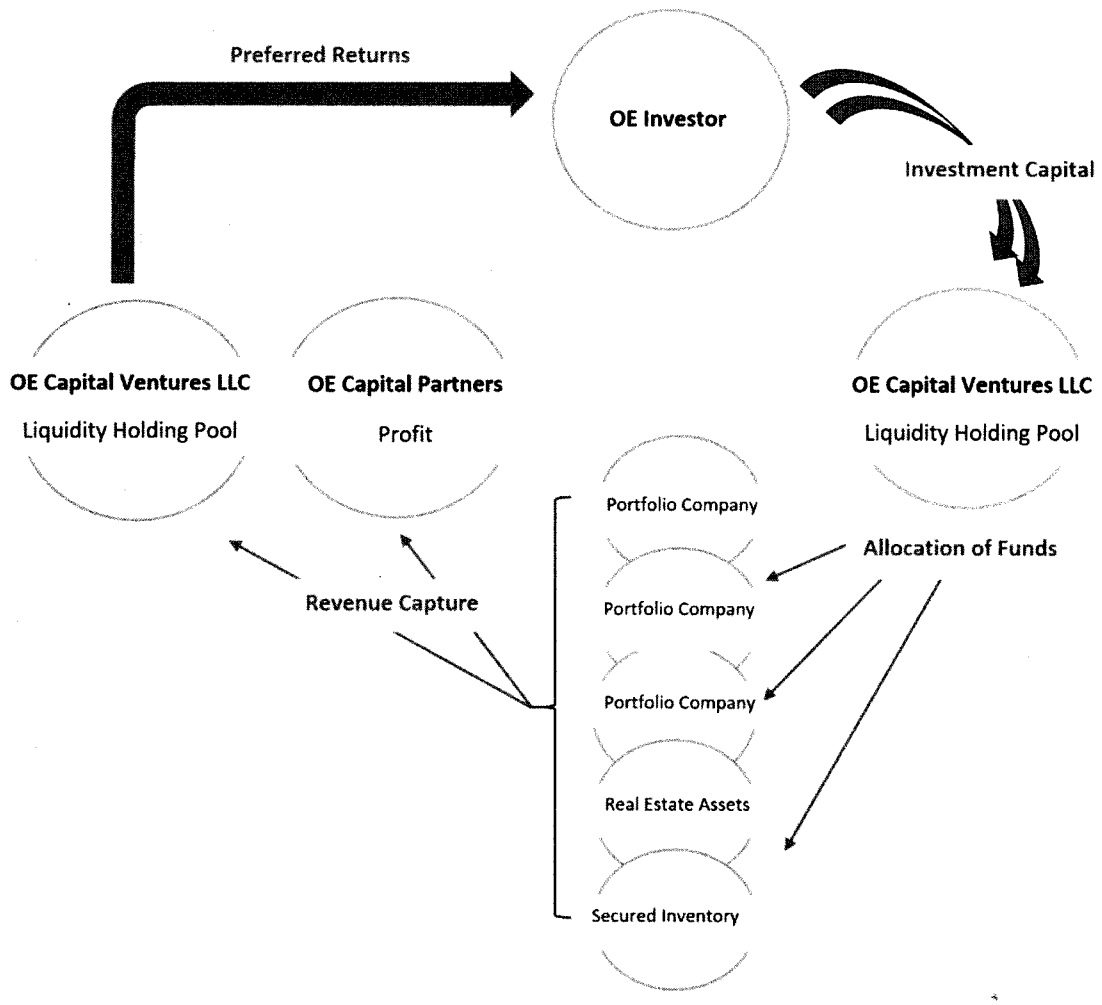
Each PPM provided that the fund would use proceeds from Unit sales to make investments in third-party companies. The CFG I PPM specified that the fund would use the offering proceeds "to purchase royalty revenue interest from CFG Inc. and its affiliates and associates." App. 552. The CFG II and OE Fund PPMs provided that those funds would use the offering proceeds to invest in unspecified third-party companies—referred to as "portfolio" companies—in exchange for a right to receive a portion of the companies' future revenue. App. 626, 683. A CFG I partnership agreement and the PPMs for CFG II and OE Fund explained that the Funds stood to profit as the portfolio companies paid the revenue interests that the funds were entitled to receive. App. 586, 635, 683.

In exchange for Units, investors paid their investment dollars over to the Defendants, who pooled those investments into a fund. App. 977, 982-984, 990. Collectively, investor fortunes were dependent on the efforts and expertise of the Defendants. And the inventors' role in the Funds was entirely passive, limited to contributing money and expecting profits based

upon the Defendants' efforts. Therefore, the Units were securities, specifically investment contracts.

Diagram A below, from the OE Fund PPM, depicts OE Fund's "Flow of Funds," showing that investors would purportedly earn investment returns as the portfolio companies paid revenue into the fund. App. 683. Although the diagram below relates specifically to the OE Fund, it accurately illustrates the general investment structure common to all three Funds. App. 108, 586, 635, 856, 862.

Diagram A



D. Promised Minimum Returns of 12% Annually

In each fund, Howard represented to investors that they would earn a minimum return of 12% annually, paid quarterly. For the CFG I offering, Howard made this representation in telephone calls to investors and in a CFG I partnership agreement that he distributed to investors. App. at 104, 108, 586, 601. For CFG II and OE Fund, he made this representation in their respective PPMs and in the Investor Packet. App. 643, 702, 760, 856, 911.

Howard also touted the 12% minimum return in an extensive radio-advertising campaign he financed on a station in Tampa, Florida, where C4 Benefits had an office. App. 124, 285, 288-289, 804. These advertisements, which Howard reviewed and approved, likewise contained representations that investors would earn a 12% annual return at a minimum. App. 288, 797-799, 802.

E. Misuse of the Offering Proceeds

Through Howard Capital and OE Capital, Howard knowingly, or with severe recklessness, used the proceeds from Unit sales in each of the Funds contrary to representations in the Investor Packet, the PPMs, and the partnership agreements.

1. Misappropriation of the CFG I Offering Proceeds

Howard misappropriated and misapplied all of the $833,993 raised in the CFG I offering. According to the CFG I PPM, the Fund intended to devote 89% of the offering proceeds to investments in portfolio companies and just 9% to marketing and corporate expenses. App. 563. In reality, however, Howard directed approximately $290,000 (34% of the proceeds) into Howard Capital's bank account. App. 50, 577, 982. He directed approximately $474,000 (57% of the proceeds) to his former business partner's company, which temporarily served as a managing member of CFG I. App. 9-10, 13-15, 550, 982. And he paid $50,000—just 5.9% of

the offering proceeds—for a revenue interest in a single company. App. 103, 982. Contrary to the CFG I PPM, however, this company was not associated with CFG Inc. App. 36. Howard spent the remainder of the CFG I offering proceeds on, among other things, office rent and payroll. App. 982. CFG I earned nothing from the $50,000 portfolio-company investment. *Id.*

2. Misappropriation and Misapplication of the CFG II and OE Fund Offering Proceeds

Of the approximately $12.26 million raised in the CFG II and OE Fund offerings, combined, Howard only invested approximately $7.4 million in portfolio companies. App. 978, 983-984. This represents just 60% of the total proceeds raised in these two funds, far below the minimum 75% represented in their PPMs. App. 372, 409, 444, 489, 640, 694. In addition, the CFG II PPM and OE Fund PPM limited spending for corporate expenses to 18% and 20% of the offering proceeds, respectively. *Id.* Howard exceeded these spending limits in both funds. App. 978. Moreover, in addition to paying himself salary and bonus, Howard transferred $226,000 to his personal bank account and paid an additional $197,000 to buy out a former business partner who was temporarily associated with CFG I. App. 14, 988.

The CFG II PPM provided that the fund would use at least 2% of the offering proceeds to purchase "whole life insurance contracts on the principals" of the portfolio companies. App. 633, 640. But Howard exhausted all CFG II offering proceeds without applying any funds to purchase the promised insurance policies. App. 979.

3. Ponzi Payments

Howard used CFG II and OE Fund offering proceeds to make Ponzi payments. As of December 31, 2016, these two funds had collectively received only $33,334 in revenues from the approximately $7.4 million they had invested in portfolio companies—a return on the investors' capital of just 0.25%. App. 978-980. Through the same date, however, Howard paid investors in

the three Funds combined a total of $169,000, purporting to be quarterly earnings distributions. App. 980. Of the $169,000 distributed, $146,000 constituted Ponzi payments: The CFG I investors received money invested by CFG II and OE Fund investors. *Id.* And the CFG II investors received money invested by later CFG II investors and OE Fund investors. *Id.*

4. Inability to Meet Financial Obligation to Investors

As of December 31, 2016, the Funds were collectively obligated to pay returns to investors totaling more than $1 million, based on the minimum return of 12% per year. *Id.* Under the Funds' combined earnings rate of 0.25% from inception through December 31, 2016, the Funds were financially incapable of satisfying this $1 million obligation—whether in cash or in reinvested dividends—within the three-year investment period. *Id.* In fact, under the 0.25% earnings rate, it would take the Funds approximately 30 years just to pay the $1 million owed to investors as of December 31, 2016. *Id.*

F. Untrue and Misleading Statements

1. 12% Minimum Returns

Throughout the fund offerings, as shown above, Howard represented to investors that they would receive minimum returns of 12% annually for three years. This representation was misleading because it omitted to disclose that the Funds' actual earnings—0.25%, shown above—were insufficient to pay the returns as represented.

2. Phony Account Statements

Through OE Capital, Howard sent investors account statements containing untrue statements regarding the status of their investments. For each investor who elected to reinvest quarterly distributions, the statement showed that the investor's account had been credited with the minimum return. App. 980-981, 994-995. These statements were false. In reality, as

mentioned above, the Funds generated only $33,334 in earnings as of December 31, 2016, while the total reinvested earnings was nearly $1 million. Therefore, no money was actually reinvested as represented. App. 981.

For those investors who received distribution payments, the statements described these payments as a "Preferred Return." App. 993. But, as shown above, the so-called Preferred Return was actually derived from payments made by other investors to purchase Units. Thus, the payments were Ponzi payments, not payments of earnings. The account statements were false because they labeled Ponzi payments as a return or yield.

3. Registered Investment Adviser ("RIA")

The Investor Packet contained brief biographical information about Howard, describing him as follows: "Patrick Howard . . . CEO, Optimal Economics, RIA." App. 96, 97, 762, 857, The CFG II PPM likewise referred to Howard as an "RIA." App. 619. These statements were untrue. Howard has never been an RIA, registered either with the SEC or with any state. App. 96.

4. OE Capital Average Growth

OE Capital represented to investors that the Funds' minimum annual return was 12%, but that they were actually earning 20% on average. App. 810. The Investor Packet contained a chart, reviewed and approved by Howard, comparing the Funds to other investment vehicles such as 401Ks, money market funds, and IRAs, among others. *Id.* A copy of the chart, below, shows OE Capital earning an average 20% growth compared to a 1-8% average growth for the other investment vehicles. *Id.* In reality, OE Capital based the 20% return on forecast modeling, but failed to disclose that it was a forecast, not a reflection of actual results. App. 177. In reality, the 20% return forecast was false. It had no reasonable basis, as demonstrated by the

Funds' actual rate growth rate—0.25%.

Acceptable Investment Accounts

Account Type	Avg. Growth	Taxes Applied Upon Withdrawal	Early Withdrawal Fees	Option for Income	Liquid
Money Markets	3%	Income Tax	No	Yes	Yes
401K	5%	Income Tax	Yes	No	No
IRA	6-8%	Income Tax	Yes	No	No
Fixed Annuity	2-3%	Income Tax	Yes	No	No
403B	4-5%	Income Tax	Yes	No	No
Savings	1.00%	None	No	Yes	Yes
Mutual Funds * Non-Qualified	6-8%	Capital Gains Tax	No	Yes	Yes
CDs	1.00%	Income Tax	Yes	No	No
Real Estate	3-4%	Capital Gains Tax	No	Yes	No
OECP Benefits	20%	Capital Gains Tax	No	Yes	Quarterly Distribution 12% preferred yield & share in waterfall 80/20 annually up to 20%, or reinvest for compound principle after 3 yrs.

5. Insurance-Based Assets

Howard made misleading statements about insurance to give the appearance that the Unit investment was safe. The CFG I partnership contract referred to the offering proceeds as "insured liquidity." App. 582. The OE Fund PPM contained a statement that the fund depended on "insurance based assets purchased to offset company underperformance." App. 706. In the CFG II PPM and the Investor Packet, Howard expressly emphasized the importance of insurance-based assets in mitigating the risk of an otherwise speculative investment, stating:

> The purchase of Units is a speculative investment. However, the Company is backing the minimum preferred yield and principal with insurance based assets. While this should not be considered a guarantee, the company separates the risk of the underlying assets, from the return of the investor. Therefore, there is assurance of the return of principal and minimum yield distribution.

App. 632, 857.

In reality, insurance provided no assurance of the return of principal and minimum yield distribution, and the statements regarding insured liquidity and insurance-based assets were

untrue. They simply referred to Howard's idea to purchase life insurance covering the portfolio companies' key officers. Not until December 28, 2016, however, did any such insurance policy exist. On that date, OE Capital purchased a life-insurance policy on a single portfolio-company officer. App. 980. From the first fund's inception through December 27, 2016, the promised minimum return was never insured or otherwise backed with insurance-based assets, nor did the Funds "backstop portfolio underperformance" with such assets.

Moreover, insuring the life of a portfolio-company officer would provide no protection against risk caused by factors other than officer death, such as competition, undercapitalization, officer incompetence, or mismanagement. The claim that insurance-based assets provided assurance of principal and yield was therefore misleading.

6. Real Estate

In a section titled "Risk Mitigation," the OE Fund PPM stated that "OE Capital Partners does not solely depend on insurance based assets as a backstop to portfolio underperformance. Other assets classes such as real estate and inventory holdings back the capital injections into portfolio companies." App. 707. In addition, the Investor Packet contained a pie chart including real estate as a slice of the portfolio-asset management strategy. App. 761. Under the pie chart, it said, "[o]ur portfolio investment strategy distributes investment funds into portfolio companies, insured liquidity assets and stop loss real estate to achieve a dynamic approach for growth." *Id.* These statements were untrue. In reality, neither OE Capital nor the Funds ever purchased any real estate. App. 112, 989.

7. Signed Contracts

In March 2016, OE Capital sent existing and prospective investors an Annual Report for 2015. App. 53, 892, 915. In an executive-summary section, the Annual Report, stated, "This

financial report is done in conjunction with" a specified certified public accounting firm. App. 737, 740. In a section discussing "Risk Coverage," it stated, "Risk is relatively low when comparing Total Capital Acquired ($4,371,859) to Total Asset Based Valuation ($7,590,604)," parentheses in original. App. 745. Among OE Capital's total assets, the Annual Report included "signed contracts" purportedly valued at $6,348,200. *Id.*

The Annual Report was misleading. The $6,348,200 signed-contract value was assigned by Howard, not by the certified public accounting firm or by any independent appraisal of the contracts. App. 199. The Annual Report omitted to disclose that Howard assigned the contract value. By omitting this disclosure while stating that the Annual Report was made "in conjunction with" the certified public accounting firm, the Annual Report conveyed the misleading impression that the certified public accounting firm agreed with the valuation.

IV. Memorandum of Law and Argument

A. The Units are Securities

The Units offered and sold in all three funds were securities. The Defendants admitted as much in the fund PPMs, which specifically referred to the Units as "securities." Moreover, the Units fit the definition of investment-contract securities. Securities Act Section 2(a)(1) [15 U.S.C. § 77b(a)(1)] and Exchange Act Section 3(a)(10) [15 U.S.C. § 78c(a)(10)] define the term security to include an "investment contract." In *SEC v. W.J. Howey Co.*, the Supreme Court held that an investment contract exists where (1) a person invests his or her money, (2) in a common enterprise, and (3) with the expectation of profits derived solely from the efforts of the promoter or a third party. 328 U.S. 293, 298-99 (1946). The definition of a security "embodies a flexible rather than static principle, one that is capable of adaptation" and requires an analysis into the substance rather than the form of the transaction with an emphasis on economic reality. *Howey*,

328 U.S. at 298-99; *see also United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 850 (1975); *SEC v. Edwards*, 540 U.S. 389 (2004).

Here, Units meet the *Howey* test. First, investors paid cash directly to accounts controlled by Howard. Second, they invested in a "common enterprise" because the investors' fortunes were dependent on the efforts and expertise of Howard Capital and OECP, which is sufficient to satisfy the "broad vertical commonality" required in the Fifth Circuit. *See SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 479 (5th Cir. 1974). Third, the investors' role was entirely passive and they were expected to realize profits based solely from the efforts of Howard, Howard Capital, and OE Capital.

B. Securities-Registration Violations: Securities Act Sections 5(a) and 5(c) [15 U.S.C. § 77e(a) and (c)]

The SEC has established a prima facie case that the Defendants violated Securities Act Sections 5(a) and 5(c) Section 5(a) [15 U.S.C. § 77e(a) and (c)]. Section 5(a) prohibits the direct or indirect sale of securities through the mail or interstate commerce unless a registration statement has been filed and is in effect. Section 5(c) prohibits the offer or sale of securities through the mail or interstate commerce unless a registration statement has been filed with the SEC. *Scienter* is not an element of a Section 5 violation. *Aaron v. SEC*, 446 U.S. 680, 714 n.5 (1980); *Swensen v. Engelstad*, 626 F.2d 421, 424 (5th Cir. 1980).

To establish a *prima facie* case under these provisions, the SEC must prove that (1) no registration statement was in effect or had been filed as to the offering; (2) the defendants, directly or indirectly, sold or offered to sell the securities; and (3) the offer or sale was made through the use of interstate facilities or the mails. *SEC v. Spence & Green Chem. Co.*, 612 F.2d 896, 901-902 (5th Cir. 1980), *see SEC v. Offill*, 2012 U.S. Dist. LEXIS 48364 (N.D. Tex. 2012). Once a *prima facie* violation is established, the defendants must prove that the securities offering

qualified for an exemption to avoid liability. *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953). Courts construe these exemptions narrowly. *SEC v. Murphy*, 626 F.2d 633, 641 (9th Cir. 1980).

Here, the evidence establishes that the Defendants offered and sold securities in the form of the fund Units, that they used interstate means, namely the email and telephone, and that no registration statement was filed with the SEC for these transactions. The SEC has therefore established a prima facie case that the Defendants violated Sections 5(a) and 5(c).

C. Anti-fraud Provisions: Securities Act Section 17(a) [15 U.S.C. § 77q(a)] and Exchange Act Section 10(b) [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5]

The Defendants violated Securities Act Section 17(a) [15 U.S.C. § 77q(a)] and Exchange Act Section 10(b) [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. § 240.10b-5]. Securities Act Section 17(a) provides in relevant part:

> It shall be unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—
>
> (1) To employ any device, scheme, or artifice to defraud, or
>
> (2) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
>
> (3) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a).

A statement or omitted fact is material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision. *SEC v. Seghers*, 298 Fed. Appx. 319, 328 (5th Cir. 2008); *see also SEC v. Gann*, 565 F.3d 932, 937 n.17 (5th Cir. 2009)

Exchange Act Section 10(b) makes it unlawful to use or employ any manipulative or

deceptive device in connection with the purchase or sale of any security in contravention of prescribed Commission rules. 15 U.S.C. § 78j(b). Exchange Act Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (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.

Violations of Securities Act Section 17(a)(1) and Exchange Act Section 10(b) and Rule 10b-5 require showing *scienter*—a mental state embracing intent to deceive, manipulate, or defraud—but showing negligence suffices for Securities Act Sections 17(a)(2) and (3) violations. *Aaron v. SEC*, 446 U.S. 680, 691, 697 (1980). *Scienter* is established by showing that the defendant acted intentionally or with severe recklessness. *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961 (5th Cir. 1981). A company's *scienter* can be imputed from its management and individuals who control it. *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1089, n.3 (2d Cir. 1972); *see, e.g., Southland Sec. Corp. v. INSpire Ins. Solution, Inc.*, 365 F.3d 353, 366 (5th Cir. 2004).

A defendant "makes" a statement if the defendant is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135 (2011). A violation of these provisions only occurs if the alleged misrepresentations or omitted facts were material. Information is material if there is a substantial likelihood that a reasonable investor would consider such information important in making an investment decision or if the information

would significantly alter the total mix of available information. *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988); *U.S. v. Bruteyn*, 686 F. 3d 318, 323 (5th Cir. 2012).

1. Untrue and Misleading Statements of Material Fact

The Defendants violated Securities Act Section 17(a) and Exchange Act Section 10(b) and Rule 10b-5 by making untrue and misleading statements of material facts. As set forth in detail above, they obtained money from investors through the sale of securities by means of numerous material misstatements and omissions regarding: (1) Howard's status as an RIA; (2) the source and amount of investor returns; (3) the risk associated with investing in the funds; (4) the use of investor proceeds; (5) accountant valuations of signed contracts; and (5) OE Capital's average growth. These misleading statements were material. There is a substantial likelihood that a reasonable investor would consider each of statements material in making an investment decision about the funds.

Howard, as owner and control person of Howard Capital and OE Capital, had ultimate authority over each partnership agreement, PPM, Investor Packet, and account statement containing the foregoing untrue and misleading statements and was a "maker" of the statements. Howard approved this written material and had complete control over all the bank accounts for Howard Capital, OE Capital, and all three funds. Consequently, the Defendants violated Securities Act Section 17(a) and Exchange Act Section 10(b) and Rule 10b-5.

2. Scheme to Defraud

The antifraud provisions in sections 17(a)(l) and (3) of the Securities Act and Exchange Act Rules 10b-5(a) and (c) also encompass deceptive "practices," *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 475-76 (1977), deceptive "conduct," Id. at 475 n. 15; *United States v. O'Hagan*, 521 U.S. 642, 659 (1997); and deceptive "acts," *Central Bank of Denver v. First Interstate Bank*

of Denver, 511 U.S. 164, 173 (1994); see also *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 9 (1971). In *SEC v. Zandford*, 535 U.S. 813, 815 (2002), addressing a fraudulent scheme under Rule 10b-5(a) and a fraudulent course of business under Rule 10b-5(c), the high court concluded: "Indeed, each time respondent 'exercised his power of disposition (of his customers' securities) for his own benefit,' that conduct, 'without more,' was a fraud." (emphasis added); see also *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 152 (1972) (noting that while Rule 10b-5(b) targets false statements or omissions, paragraphs (a) and (c) "are not so restricted").

Throughout the Unit offerings, the Defendants engaged in a practice and course of business of misappropriating, misapplying, and misusing investor funds. They invested Unit proceeds in portfolio companies far below the levels represented in the PPMs and other documents. They diverted funds to Howard's personal bank account, to pay Ponzi payments, and to buy out his former business partner. And they engaged in a fraudulent scheme or course of business by sending investors account statements that created the impression that OE Capital was earning the promised 12% returns, when, in reality, its revenues were far too low to make the promised returns within the three-year investment period. These fraudulent practices demonstrate that the Howard, OE Capital, and Howard Capital were engaged in an overall scheme to defraud. S*ee Zandford*, 535 U.S. at 819-21; *Grippo v. Perazzo*, 357 F.3d 1218, 1223 (11th Cir. 2004).

3. *Scienter*

The Defendants acted knowingly or, at a minimum, with severe recklessness. As the person controlling the funds' bank accounts, Howard knew, or was severely reckless in not knowing, the amount, source, and disposition of the Unit proceeds that flowed into and out of

those accounts. As the funds' manager and control person, he knew, or was severely reckless in not knowing, the amount of money the funds were investing in portfolio companies. As such, he also knew, or was severely reckless in not knowing, the actual rate of return that the funds were realizing on their investments. As the person who reviewed and authorized each partnership agreement, PPM, and Investor Packet, he knew or was severely reckless in not knowing the statements contained within those documents.

He therefore knew or was reckless in not knowing: (1) that the proceeds from Unit sales were spent in a manner at gross variance with the representations in each partnership agreement, PPM, and Investor Packet; (2) that the Investor Packet described him as an RIA, when, in fact he was not an RIA; (3) that portfolio-company revenue was utterly inadequate to pay the promised returns within the investment period; (3) that the funds did not purchase insurance or real estate as represented; (4) that the funds were making Ponzi payments; (5) that no independent accountant concurred with the valuations of the signed contracts; and (5) that OE Capital's average growth was 0.25% not 20%. Nevertheless, under Howard's direction the funds continued to raise money from investors. Thus, Howard acted with *scienter*. Because his *scienter* imputes to Howard Capital and OE Capital, they too possessed the requisite *scienter* for liability under the anti-fraud provisions.

D. Emergency and Other Ancillary Relief

1. The Court should issue a temporary restraining order *ex parte* and a preliminary injunction to enjoin the Defendants' violative acts and practices.

Rule 65(b) of the Federal Rules of Civil Procedure empowers a court to grant an *ex parte* temporary restraining order ("TRO") to prevent immediate and irreparable injury, loss, or damage. Fed. R. Civ. P. 65(b). Unlike private litigants, however, the Commission is not

required to show a risk of irreparable injury, loss, or damage to obtain a TRO.[2] *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 808 (2d Cir. 1975); *Unifund*, 910 F.2d 1028, 1036 (2nd Cir. 1990).

Section 20(b) of the Securities Act [15 U.S.C. § 77t(b)] and section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)] authorize the Commission to seek and direct the courts to enter "a permanent or temporary injunction or restraining order" upon a "proper showing" that the defendant "is engaged or is about to engage" in violations of the securities laws. In the Fifth Circuit, the Commission makes a proper showing and "is entitled to prevail when the inferences flowing from the defendant's prior illegal conduct, viewed in light of present circumstances, betoken a "reasonable likelihood" of future transgressions." *SEC v. Zale Corp.*, 650 F.2d 718, 720 (5th Cir. 1981).

To determine "reasonable likelihood," the court analyzes: (1) the nature of the past violation, (2) the defendant's present attitude, and (3) objective constraints on (or opportunities for) future violations of the securities laws. *Id.* "Such factors include the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of *scienter* involved, the sincerity of the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations." *Id.*

When the Commission has established a *prima facie* showing of violations and the

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[2] [T]he rationale for this rule is readily apparent. It requires little elaboration to make the point that the SEC appears in these proceedings not as an ordinary litigant, but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws. Hence, by making a showing required by statute that the defendant "is engaged or about to engage" in illegal acts, the Commission is seeking to protect the public interest, and "the standards of the public interest, not the requirements of private litigation, measure the propriety and need for injunctive relief.

SEC v. Management Dynamics, Inc., 515 F.2d at 808-809 (quoting *Hecht v. Bowles*, 321 U.S. 321, 331 (1944)).

likelihood that such violations will continue, issuance of a preliminary injunction is appropriate. *SEC v. First Fin. Group of Tex.* 645 F.2d 429, 434-35 (5th Cir. 1981); *SEC v. United Fin. Group, Inc.*, 474 F.2d 354, 358 (9th Cir. 1973); *SEC v. Keller Corp.*, 323 F.2d 397, 402-03 (7th Cir. Ind. 1963).

Here, the *Zale* factors militate strongly in favor of a TRO and preliminary injunction against each Defendant. Their violations to date have been extremely egregious. They have defrauded at least 119 victims of approximately $13.1 million in a succession of fraudulent securities offerings. Their violations were not isolated. Their offerings have multiplied over time, have victimized investors in more than one state, and have continued through the present. The Defendants have carried acted with extremely high *scienter*, employing false claims of "insured" minimum returns to induce investments and then misappropriating and misapplying the proceeds. And they have not recognized the wrongful nature of their conduct.

Finally, as to occupation, the Defendants remain associated with a sales force to propagate untrue and misleading statements in securities offerings. They will therefore continue to have opportunities to defraud investors. For these reasons, the SEC has made a proper showing for a TRO and preliminary injunction.

2. *Ex Parte* Orders Freezing Assets, Requiring Document Preservation, Requiring an Interim Accounting, Permitting Alternative Service, and Expediting Discovery

Federal courts have broad equitable powers enabling them to fashion appropriate ancillary remedies necessary to grant full relief. *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1103-4 (2d Cir. 1972); *SEC v. Blatt*, 583 F.2d 1325, 1335-1336 (5th Cir. 1978). The Court should freeze the Defendants assets based on the misconduct described above. Such an order is appropriate to prevent dissipation pending an assessment of the assets' value and liquidity and

their return to investors. *See, e.g., SEC v. Manor Nursing Centers, Inc.*, 458 F.2d at 1106. The Defendants' wrongdoing amply demonstrates that they should not be entrusted with investor funds.

An asset freeze is also appropriate to assure satisfaction of whatever equitable relief the Court ultimately may order. *Id.*; *Commodity Futures Trading Com. v. Muller*, 570 F.2d 1296, 1300 (5th Cir. 1978). Additionally, an asset freeze "facilitate(s) enforcement of any disgorgement remedy that might be ordered" and may be granted "even in circumstances where the elements required to support a traditional SEC injunction have not been established." *SEC v. Unifund SAL,* 910 F.2d 1028, 1041 (2d Cir. 1990). Courts recognize that an asset freeze is sometimes necessary to ensure that a future disgorgement order will have effect. *See, e.g., United States v. Cannistraro*, 694 F. Supp. 62, 71 (D.N.J. 1988), *aff'd in part, vacated in part on other grounds*, 871 F.2d 1210 (3d Cir. 1989); *SEC v. Vaskevitch*, 657 F. Supp. 312, 315 (S.D.N.Y. 1987); *SEC v. R. J. Allen & Associates, Inc.*, 386 F. Supp. 866, 881 (S.D. Fla. 1974).

To obtain an asset freeze, the Commission need not show a reasonable likelihood of future violations. *Commodity Futures Trading Com. v. Muller*, 570 F.2d at 1300. Its burden is lower than that of a preliminary injunction because an asset freeze only preserves the *status quo*. *Unifund SAL*, 910 F.2d at 1039.

In addition, the Court should enter an order prohibiting the movement, alteration, and destruction of books, records, and accounts to prevent destruction of documents before the Commission's claims can be adjudicated. To more fully ascertain the extent of the Defendants' misconduct, the Court should order the Defendants to submit an interim accounting on an expedited bases and order expedited discovery in anticipation of a hearing on the Commission's request for a preliminary injunction. Finally, the Court should issue an order permitting

alternative service of pleadings and other papers. These orders will assure that whatever equitable relief might ultimately be granted is available and meaningful. *See R. J. Allen & Assocs., Inc.*, 386 F. Supp. at 881.

3. *Ex Parte* Order Appointing a Receiver

As set forth above, pursuant to their general equity powers, courts may order ancillary relief to effectuate the purposes of the federal securities laws, to preserve defendants' assets, and to ensure that wrongdoers do not profit from their unlawful conduct. In this regard, the power of the district court to appoint a receiver to marshal and preserve assets and perfect property rights is well-established. *SEC v. First Financial* Group, 645 F.2d 429, 438 (5th Cir. 1981). *See also* 12 C. Wright, A. Miller & R. Marcus, "Federal Practice & Procedure" §2983 at 23-24 (2d ed. 1997). An evidentiary hearing is not required on Plaintiff's request to appoint a receiver where the record discloses sufficient facts to warrant such an appointment. *Bookout v. Atlas Fin. Corp.*, 395 F. Supp. 1338, 1342 (N.D. Ga. 1974), *aff'd*, 514 F.2d 757 (5th Cir. 1975).

The evidence presented here establishes that Defendants have misappropriated and misapplied millions of dollars received from investors and are in possession of investor assets or assets acquired with investor funds that are at risk of disappearing any moment. The Defendants may have transferred investor money to other parties, who may not have a legitimate claim to retain possession of that money or those assets. Under these circumstances, appointment of a receiver to marshal, conserve, and hold Defendants property and other property traceable to the fraud is essential to providing meaningful recovery for the scheme victims.

4. *Ex parte* treatment is necessary as to this ancillary relief.

The accompanying Rule 65 certification and annotated fact brief clearly show that immediate and irreparable injury, harm, or damage will result to the SEC before the Defendants

can be heard in this case. As reflected in the Complaint, the Commission seeks an order requiring the Defendants to disgorge an amount equal to the illegal profits and other benefits they received as a result of the violations. If the Defendants receive notice of this action before the requested ancillary relief is entered, then the Defendants will have the opportunity to dissipate, secrete, encumber, and place outside the Court's jurisdiction assets they obtained from the scheme's victims. They will also have an opportunity to destroy, alter, or mutilate evidence needed to determine the full scope of the scheme.

Such actions will create irreparable injury to the Commission by preventing it from collecting all funds and assets it is entitled to collect from the Defendants in connection with the disgorgement order the Commission seeks. It will create further irreparable injury by greatly diminishing the Commission's law-enforcement goal of returning assets acquired in this scheme to their rightful claimants through the appointment of a receiver.

VII. CONCLUSION

Based on the foregoing facts and for the reasons set forth above, the Commission respectfully requests that the Count enter orders providing the relief requested.

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Respectfully submitted,

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