IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,	:	
	:	
Plaintiff,	:	
	:	
vs.	:	Civil Action No.
	:	
AMERIFIRST FUNDING, INC.,	:	
AMERIFIRST ACCEPTANCE CORP.,	:	
JEFFREY C. BRUTEYN,	:	
DENNIS W. BOWDEN,	:	
	:	
Defendants,	:	
	:	
and,	:	
	:	
AMERICAN EAGLE ACCEPTANCE CORP.,	:	
HESS FINANCIAL CORP.,	:	
	:	
Relief Defendants.	:	
	:	

MEMORANDUM IN SUPPORT OF PLAINTIFF'S APPLICATION FOR TEMPORARY RESTRAINING ORDER, ORDER TO SHOW CAUSE RE PRELIMINARY INJUNCTION, ASSET FREEZE ORDER, REPATRIATION ORDER, ORDER FOR AN ACCOUNTING, AND FOR OTHER EMERGENCY RELIEF AND FOR APPOINTMENT OF A RECEIVER

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I. PRELIMINARY STATEMENT

Plaintiff United States Securities and Exchange Commission ("Commission") submits this Memorandum of Law in support of its Ex Parte Application for a Preliminary Injunction and an Asset Freeze Order and Other Relief to halt ongoing violations of the law and protect its ability to recover investor funds misappropriated in a fraudulent securities scheme perpetrated by Defendants AmeriFirst Funding, Inc. ("AFI"), AmeriFirst Acceptance Corp. ("AAC") (collectively "AmeriFirst"), Jeffrey C. Bruteyn ("Bruteyn"), and Dennis W. Bowden ("Bowden").

Beginning no later than January 2006, Defendants have engaged in the fraudulent, unregistered offer and sale of securities denominated "Secured Debt Obligations" ("SDOs"). To date, Defendants' offering of these SDOs has raised at least $35 million, and perhaps as much as $55 million, from more than 300 investors in several states.

The Defendants represent to investors, many of whom are elderly or saving for retirement, that these securities are comparable in safety to certificates of deposit insured by the Federal Deposit Insurance Corporation ("FDIC"). Investors are told that the SDOs are low in risk because they are guaranteed by a commercial bank and accounts are protected from loss by numerous insurance policies. Defendants further represent that each investor's funds will protected by collateral and, at all times, either held in cash in a separate client account or invested in conservative investments, such as Treasury Notes or AAA-rated corporate bonds. Finally, AmeriFirst touts the credentials of Bruteyn and Bowden, with no qualifications or caveats.

In reality, customers' investments in the AmeriFirst SDOs are not guaranteed by a commercial bank or protected by many layers of insurance, as claimed by Defendants;

the investments, in fact, are not insured at all. Moreover, investor funds have been pervasively misused for unauthorized and undisclosed purposes. Millions of investor dollars have been misappropriated for the personal use and benefit of AmeriFirst's principals. Millions more have been invested, contrary to the explicit promises made to AmeriFirst curstomers, in high-risk securities such as junk bonds, options and technology stocks.

Furthmore, AmeriFirst investors have not been told that Bruteyn, AmeriFirst's Managing Director, has a long record of financial irresponsibility and securities-related violations. These include two personal bankruptcies within the past decade and numerous regulatory actions against Bruteyn by the National Association of Securities Dealers ("NASD"), including an order permanently barring Bruteyn from future association with any NASD member broker or dealer.

By their conduct, Defendants have violated, and continue to violate, Sections 5(a), 5(c) and17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§77e(a), 77e(c) and 77q(a)] and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)] and of Rule 10b-5 [17 C.F.R. § 240.10b-5], promulgated thereunder.

In addition to the Defendants, the Commission has named American Eagle Accpetance Corp. ("American Eagle") and Hess Financial Corp. ("Hess") as Defendants solely for the purpose of equitable relief. These Relief Defendants received and control millions of dollars in cash and property attributable to investor money.

Based on the present use of investor funds, AmeriFirst, like Brutyen's past business ventures, is likely headed toward a financial collapse. Emergency relief is needed to prevent Defendants from victimizing additional investors, to circumscribe the

danger and damage to existing investors, and to recover funds and assets to provide restitution to Derfendants' victims.

By this application, the Commission seeks: (1) temporary restraining orders and preliminary injunctions against future violations; (2) an immediate freeze of defendants' and relief defendants' assets to preserve the *status quo* pending final judgment; (3) an order requiring defendants and relief defendants to file and serve an accounting; (4) an order prohibiting defendants and relief defendants from destroying books, records and documents; (5) an order expediting discovery; (6) a repatriation order; and (7) an order appointing a Temporary Receiver to marshal, conserve, and, where necessary, operate the assets of Defendants and assets of Relief Defendants derived from the fraudulent conduct.

II. DEFENDANTS

A. Jeffrey C. Bruteyn, age 37, of Dallas, Texas, is Managing Director of Amerifirst Funding, Inc. and Amerifirst Acceptance Corporation and the Director and sole owner of Hess Financial Corporation. [App. at 002-003, 012-14, 016, 142, 143, 144, 148, 151-52, 154, 157][Oses Dec. at ¶¶ 3-7 and 43, Exhs. 1, 19, 21 and 22]. Bruteyn was an associated person of broker-dealers from approximately 1994 until January 2002, when the NASD suspended him from associating with any NASD member for 18 months and fined him $15,000 for executing unauthorized trades, failing to follow customer instructions and making misrepresentations. *See* NASD Case No. C06010029. [App. at 003, 012-14, 187A-187F][Oses Dec. at ¶¶ 11 and 43, Exh. 24]. In March 2002, the NASD ordered him to pay an arbitration award of $287,000 to a former client for breaching his fiduciary duties, churning the customer's account, making misrepresentations and omitting information, negligence in handling the account and

unauthorized trading. *See* NASD Arbitration Case No. 01-01435. [App. at 003, 012-14, 409-408][Oses Dec. at ¶¶ 12 and 43, Exh. 39]. Finally, in August 2003, the NASD permanently barred Bruteyn from associating with any NASD member, as punishment for his failure to respond to the NASD's requests for documents and information. *See* NASD Case No. 8210-06030002. [App. at 004, 012-14, 000171-191][Oses Dec. at ¶¶ 13 and 43, Exh.23]. Bruteyn was also the CEO of American Securities Corp., an NASD member broker-dealer whose registration was cancelled while under suspension for failing to respond to a request for financial information and failing to pay a fee. [App. at 044, 012—14, 187A-187B, 187AA-187DD][Oses Dec. at ¶¶ 14 and 43, Exh. 24]. In addition, Bruteyn filed "no-asset" Chapter 7 personal bankruptcies in 1996 and 2003 and received a discharge of debts in 1998 and 2004, respectively. [App. at 003, 012-014, 188-190][Oses Dec. at ¶¶ 8, 9 and 43, Exh. 25].

B. **Dennis W. Bowden,** age 55, of Dallas, Texas, is the president of Amerifirst Funding, Inc., a director and chief operation officer of Amerifirst Acceptance Corporation and president and COO of American Eagle Acceptance Corporation. [App. 007-008. 012-14, 078-090, 113-41, 154, 156][Oses Dec. at ¶¶ 3-7, 43, Exhs. 19, 20 and 22].

C. **Amerifirst Funding, Inc.**, is a Texas corporation operated and controlled by Bruteyn and Bowden. [002, 012-014, 015-16, 047, 048, 049 and 078-91, [Oses Dec. at ¶¶ 3, 43, Exhs. 1, 6, 7, 8 and 19] It is in the business of offering "Secured Debt Obligations" and is an issuer of these securities. [App. at 004, 0012-14, 015-51, 154-166][Oses Dec. at ¶¶ 16 through 18 and 43, Exhs. 1 through 10, 22 and, 43]. These securities have not been registered under the Securities Act or Exchange Act, nor are they registered with any state. [App. 012-14, 413, and 437][Oses Dec. at ¶¶ 40 and

43, Exh. 41; Aponte Dec. at ¶ 17]. AFI has never registered a securities offering under the Securities Act and has not registered any class of securities under the Exchange Act. {Oses Dec. at ¶ 38].

D. Amerifirst Acceptance Corporation, is a Texas corporation incorporated in February 2006 and controlled by Bruteyn and Bowden. [App. 002, 012-014, 106-111, 153-166, 430, 438-443][Oses Dec. at ¶¶ 4, Exh. 19 and 22, Apponte Dec. at ¶¶ 2 and 3, Exhs. 1 and 2]. It is in the business of offering "Collateral Secured Notes" ("CSNs") and is an issuer of these securities. [App. at 010, 0120-014, 034, 0154-66][Oses Dec. at ¶¶ 38 and 43, Exhs. 2 and 22]. The CSNs are essentially identical to the SDOs, but are only marketed directly by AmeriFirst.[1] [*id.*]. The CSNs have not been registered under the Securities Act or Exchange Act, nor are they registered with any state. [App. 012-14, 413, and 437][Oses Dec. at ¶¶ 40 and 43, Exh. 41; Aponte Dec. at ¶ 17].. AAC has never registered a securities offering under the Securities Act and has not registered any class of securities under the Exchange Act. [*id.*].

III. RELIEF DEFENDANTS

A. American Eagle Acceptance Corporation is a Texas corporation controlled by Bowden and held out to be a subsidiary of Amerifirst Funding. [App. at 002, 012-014, 112-41][Oses Dec. at ¶ 5, Exh. 20]. American Eagle operates car lots under the assumed-name Central Park Motercars pursuant to Motor Dealer Finance Licenses issued by the State of Texas; it is the maker of notes for car loans funded by Amerifirst Funding and Amerifirst Acceptance. [App. at 002, 004-005, 012-014, 018, 034, 060-061 and 112-141][Oses Dec. at ¶¶ 5, 19, 20, and 43, Exhs. 1, 2, 13 and 20].

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[1] In order to simplify the discussion in this Memorandum, both securities will be referred to jointly as SDOs.

B. Hess F+inancial Corporation, is a Texas corporation controlled by Bruteyn. [App. at 002, 0120, 014, 143-152][[Oses Dec. at ¶ 6, Exh. 21]. Hess received millions of dollars in "consulting fees" from AFI and other related entities. [App. at 010-011, 419, 422, and 427][Oses Dec. at ¶¶ 38 amd 39c, Exh. 43 (Rector Dec. at ¶ 6, Exh. A) and Exh. 44]. Bruteyn used some of these funds to pay "referral fees" to AFI sales agents. [*id.*]. In addition, Hess has used millions of dollars of these investor funds to purchase real estate in the Dallas area and elsewhere. [App. at 010-011, 012-014, 063, 064, 415, 417, 419 and 423] [Oses Dec. at ¶¶ 43a, 43c and 43d, Exhs. 14, 15 and 43 9Rector Dec. at ¶ 6, Exh. A) and 44].

IV. THE FRAUDULENT SCHEME

A. The AmeriFirst SDO Offering in General

Since at least January 2006, Bruteyn and Bowden, through AmeriFirst, have been conducting an ongoing offering, raising at least $35 million, and as much as $55 million, from the sale of SDOs to more than 300 investors located primarily in Texas and Florida. [App. at 004, 012-014, 191-200, 415 and 418][Oses Dec. at ¶¶ 16 and 43, Exhs. 25 and 43 (Rector Dec. at ¶ 8); Aponte Dec. at ¶¶ 2 through 5, Exhs. 3-9]. Both Bruteyn and Bowden control all aspects of AmeriFirst's operations, including disseminating offering documents to sales agents and investors, communicating with sales agents and investors, authorizing banking transactions, maintaining AFI and affiliated company's brokerage accounts, signing the SDO Note and Servicing Agreements, and obtaining and maintaining insurance. [App. at 002-003, 012-014, 015-033, 035-041, 047, 049, 153-166, 202-250, 298-345, 364-394, 395-407, 408, 430, 434-35, 438-440, 441-443, 521-545, 546-547, 548, 549, 550][Oses Dec. at ¶¶ 3-7, 43, Exhs. 1, 3, 6, 8, 22, 27, 33, 34, 36, 37, and 38][Aponte Dec. at ¶¶ 2, 3, 9, 10, 11 and 13, Exhs. 1, 2, 16, 17, 18 and 19].

According to offering materials, AmeriFirst, through its American Eagle subsidiary, specializes in purchasing, factoring and collecting "qualified secured automobile receivables," which are acquired on the open market from "select" car dealerships or generated through auto sales on American Eagle's handful of used car lots. These receivables supposedly secure the SDOs. [App. at 004, 012-014, 153-167][Oses Dec. at ¶¶ 17, 18 and 43, Exhs. 22].

AmeriFirst markets the SDOs as a higher-yielding, but equally safe, alternative to bank CDs, offering rates from 7% to 8% APR on 2 and 3 year terms. [App. at 005-006, 010, 012-014, 015-033, 034, 153-166, 416, 432-436, 470-550][Oses Dec. at ¶¶ 17-21, 38 and 43; Exhs. 1, 2, 22, 43(Rector Dec. at ¶ 3); Aponte Dec. at ¶¶ 6-13, Exh. 10-19]. While AmeriFirst has an in-house sales agent to process investor paperwork and respond to inquiries from potential investors attracted by AmeriFirst's website, the issuer markets the SDOs in large part through a network of sales agents in Texas and Florida. [App. at 004, 012-014, 0416, 417, 419, 422, 427, 430-31, 444-469][Oses Dec. at ¶¶ 16, 42 and 43, Exh. 43 (Rector Dec. at ¶ 3 and 6, Exhs. A and B) and 44; Aponte Dec. at ¶¶ 2-5, Exhs. 3-9]. AmeriFirst and the entities selected by AmeriFirst as sales agents hold themselves out as firms specializing in providing low-risk investments to the elderly and persons saving for retirement. [App. at 530-33, 444-520][Aponte Dec. at ¶¶ 3-6, Exhs. 3-15]

The customers who purchase the AmeriFirst investment are often lured to the offices of the sales agents by ads in local newspapers touting the availability of relatively high-yielding FDIC-insured certificates of deposit. [App. at 012-014, 052-59, 432-34, 517-520][Oses Dec. at ¶ 43, Exhs. 11 and 12][Aponte Dec. at ¶¶ 6 and 7, Exh. 15]. When conservative prospective investors respond to the advertisements, they are

instead pitched SDOs as an attractive alternative, paying a higher rate of interest while offering safety comparable to an FDIC-insured CD. [App. at 434][Aponte Dec. at ¶¶ 7 and 8].

The investment contract between AmeriFirst and its clients consists primarily of two documents: (1) a document entitled "Collateral Secured Debt Obligation;" and (2) a "Servicing Agreement" (collectively referred to as the "Agreement"). [App. at 0112-014, 015-046; 435, 546-49][Oses Dec. at ¶ 43, Exhs. 1-5; Aponte Dec. at ¶ 10, Exh. 17 and 18]. Investors send their funds directly to AmeriFirst. [App. at 012-014, 035-041, 049-051][Oses Dec. at ¶¶ 43C, 4H, 4I and 4J; Exhs. 3 and 8-10; Aponte Dec. at ¶ 13].

AmeriFirst investors may elect to receive monthly interest payments or to compound their earnings by rolling over interest payments and receiving their principal and interest when their investments mature. [App. at 010, 035-42, 436, 551-52][Oses Dec. at ¶¶ 36 and 37, Exh. 3; Aponte Dec. at ¶ 14, Exh. 20]. Most investors have elected to compound their returns; this has permitted AmeriFirst to make its scheduled monthly payments to the rest of its investors in spite of the misappropriation of investor principal and the low returns yielded by funds AmeriFirst has actually placed in investments. [*id.*].

AmeriFirst claims that it does not pay commissions or fees to its sales agents. However, bank records indicate that AmeriFirst has transferred millions of dollars of investor funds to Hess Financial as "consulting fees" and that Hess Financial has, in turn, has paid large amounts to sales agents as "referral fees." [App. at 004, 010-011, 419, 422, and 427][Oses Dec. at ¶¶ 16, 38 and 39c, Exh. 43 (Rector Dec. at ¶ 6, Exh. A) and Exh. 44]. These referral fees appear to equal 4% to 5% of the invested funds. [*id.*].

AmeriFirst promises investors that they can expect a heightened duty of candor, trust and honesty from the company and its representatives. [App. 012, 045, 435, 548-49][Oses Dec. at ¶ 43E, Exh. 5, Aponte Dec. at ¶¶ 10 and 11, Exh. 18]. The Agreement represents that "the relationship between [investor] and [AmeriFirst] will be a relationship of trust in which [AmeriFirst] shall comply with all the obligations of a fiduciary." [*id.*]. As set forth below, Defendants actions consistently belie these high-minded and comforting platitudes.

B. False and Misleanding Statements and Omissions In the Offer and Sale of AmeriFirst SDOs

1. Safety of the Investment

AmeriFirst promotional materials and contracts emphasize repeatedly the complete safety of the SDOs. Offering materials state that the investments are "guaranteed" by a commercial bank. [App. at 004-005, 017, 034, 435-36, 548][Oses at ¶¶ 19-21, Exhs. 1, 2; Aponte Dec. at ¶¶ 10-12, Exh. 18] Elsewhere, the materials claim that AFI is a "bank holding company" whose affiliate American Eagle has a "banking license from the State of Texas." [App. at 004-005, 017, 018, 034][Oses Dec. at ¶¶ 19; Exhs 1 and 2].

Amerifirst further represents that investors are insulated from risk by several layers of insurance coverage. [App. at 004-009, 016-017, 034, 037. 045, 154, 434-36, 522-23, 548, 550][Oses Dec. at ¶¶ 17-31, Exhs. 1, 2, 3, 5, 22; Aponte Dec. at ¶¶ 8-13, Exhs. 16-19]. The following statements from AmeriFirst sales literature, correspondence from Bruteyn and Bowden to investors and potential investors and the investment contracts themselves are illustrative of the issuer's representations:

- "[i]n addition to AmeriFirst's guarantee of your investment, the Fireman's Fund Insurance Group reinsures all of our receivable

accounts;" [App. at 008, 016, 434-35, 522][Oses Dec. at ¶ 26, Exh. 1; Aponte Dec. at ¶ 9, Exh. 16].

- AmeriFirst carries "a FRAUD and DISHONESTY BOND with Western Surety Company;" [App. at 009, 016-17, 034, 434-36, 522][Oses Dec. at ¶ 28, Exh. 1 and 2; Aponte Dec. at ¶¶ 8-13, Exhs. 16-19].
- AmeriFirst's obligation is "guaranteed by a Commericial Bank and reinsured by two outside AA rated insurance companies. The reinsurance companies are Allianz and Lloyd's of London;" [App. at 004-005, 017, 034, 043, 435-36, 548, 550][Oses at ¶¶ 19-21 and 23, Exhs. 1, 2 and 5; Aponte Dec. at ¶¶ 10-13, Exh. 18 and 19]
- "[f]or insured notes (AmeriFirst) agree to keep a fully covered single interest coverage policy on all uninsured receivables at all times by The American National Insurance Company;" [App. at 009, 037, 045, 434-36, 523, 548][Oses Dec. at ¶ 30, Exhs. 2 and 5; Aponte Dec. at ¶¶ 8-13, Exhs. 16-19].]
- AmeriFirst's insurance coverage is comparable to FDIC insurance.[App. at 012, 017, 034][Oses Dec. at ¶¶ 43A and 43B, Exhs. 1 and 2].

To accentuate the impact of these representations, AmeriFirst provides investors and potential investors with certificates purporting to verify the coverage by Lloyds, Allianz, Collateral Protection, Fireman's Fund and Western Surety Company. [App. at 005, 012, 019-029, 434, 529-40][Oses Dec. at ¶¶ 23

and 43A, Exh. 1; Aponte Dec. at ¶ 9, Exh. 16]. In discussing the purported insurance coverage, AmeriFirst investor materials boast that "[d]ue to the security of our Secured Debt Obligation Account, we feel that it is a perfect investment vehicle for someone in a conservative financial position." [App. at 012, 016, 434-36, 522, 550][Oses Dec. at ¶¶ 43A, Exh. 1; Aponte Dec. at ¶¶ 9 and 13, Exhs. 16 and 19].

As the name of the security implies, AmeriFirst also represents that investor accounts will be protected by collateral. The Agreement states that AmeriFirst will "provide mutually agreeable collateral to secure this note within one month of the date of execution of this Note." [012, 044, 435, 547][Oses Dec. at ¶ 43E, Exh. 5; Aponte Dec. at ¶ 10, Exh. 17].

Finally, AmeriFirst purports to assure the safety of investor funds through its conservative investment policy. AmeriFirst promises that the "funds advanced by investors shall be held either in cash in the investor's separate account, government or corporate AAA bonds, qualified receivables or publicly traded stock, namely IFHC." [App. at 009, 045, 435, 548][Oses Dec. at ¶ 34, Exh. 5; Aponte Dec at ¶ 10, Exh. 18].

In fact, AmeriFirst's contention that investor funds are virtually risk-free is built on a foundation of lies. Contrary to AmeriFirst's claim, there is no evidence that the AmeriFirst SDOs are guaranteed by a commercial bank. [004-005, 060-62, 435][Oses Dec. at ¶¶ 19-22, Exh. 13; Aponte Dec. at ¶ 11]. American Eagle is not, as represented by AmeriFirst, licensed as a commercial bank. [*id.*]. Moreover, no other commercial bank guarantees AmeriFirst's obligations to its investors. [*id.*].

AmeriFirst's description of the insurance protecting investors is also false and misleading. AmeriFirst does not carry insurance that guarantees its "receivables." [Oses

Dec. at ¶¶ 23-31]. During the relevant period, AmeriFirst has had in effect no insurance coverage from Fireman's Fund or Allianz.[2] [App. at 005, 008, 251-262, 263-272][Oses Dec. at ¶¶ 24, 27 and 28, Exhs. 28 and 29 (Smith Dec. at ¶¶ 3-12, Exhs. A through D)]. AmeriFirst's policy with Lloyds covers only losses relating to the automobiles that collateralize notes written or purchased by American Eagle. [App. at 005-008, 202-262][Oses Dec. at ¶¶ 23-25, 27A through 27F]. The Lloyd's coverage, moreover, is limited to an annual aggregate maximum of $200,000, a fraction of AmeriFirst's obligations to its investors. [*id.*].

Not only did Defendants make egregious misrepresentations about the protection provided investors by the Lloyd's policy, Defendants altered the Lloyd's certificate it put in promotional materials to confirm the lie. [App. at 005-006, 008, 248][Oses Dec. at ¶¶ 23 and 25, Exh. 25E]. The Commission staff interviewed the underwriter of the underwriter who determined to issue the limited Lloyd's policy; he stated that relevant information information was redacted from the AmeriFirst materials to conceal the policy's limitations. [*id.*]

The "fraud and dishonesty bond" issued by Western Surety covers only fraudulent and dishonest acts committed by an employee against the *company*, such as embezzlement or theft of property. [Oses Dec. at ¶¶ 28 and 29, Exh. 30 (Bruflat Dec. at ¶¶ 6-11, Exh. A through C)]. It does not protect investors or their accounts. [*id.*] Moreover, it is limited to $100,000 per employee, with an aggregate maximum coverage limit of $600,000. [*id.*].

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[2] From November 2000 until November 2003, American Eagle maintained a "force place coverage policy" through Fireman's Fund to protect collateral. [App. at 008, 264][Oses Dec. at ¶¶ 26 and 27, Exh. 29 (Smith Dec. at ¶ 10) This policy, however, was terminated in 2003, when Fireman's Fund decided that it would no longer offer this type of insurance coverage. [*id.*]. Accordingly, at the time AmeriFirst was making these representations, it had not had any coverage from Fireman's Fund for several years.

In addition, AmeriFirst has not collateralized most of its debt to investors. Only a small portion of investor funds have been placed in investments secured by collateral, specifically automobile loan receivables.[3] [App. at 005-008, 202-262][Oses Dec. at ¶¶ 23-25k].

Finally, AmeriFirst consistently deviates from its promise to place funds in specified, low-risk investments. [010, 282-412, 417, 419, 420][Oses Dec. at ¶¶ 34-35, Exhs. 31-38, 43 (Rector Dec. at ¶ 6, Exh. A]. As set forth more fully below, AmeriFirst has used millions of dollars collected from clients to purchase low-grade and speculative investments. [*id*].

2. <u>The Misappropriation and Misuse of Investor Funds</u>

AmeriFirst has not used investor funds for the purposes represented to investors. The Defendants have stolen millions of dollars and risked millions more in unauthorized investment vehicles.

Contrary to their representations to investors, Defendants have not maintained separate accounts on behalf of each of AmeriFirst's investors. [App. at 009-010][Oses Dec. at ¶¶ 33-35]. AmeriFirst has commingled investor funds in accounts controlled by Bruteyn and Bowden. [*id.*].

At least $4.7 million of investor funds have been transferred from AmeriFirst to Hess Financial's accounts and another $2.49 million of investor funds have been directly deposited in the Hess accout; Bruteyn effectively treats as his personal checking account. [App. at 011, 417-18, 419, 427][Oses Dec. at ¶ 39(c), Exh. 43 (Recter Dec. at

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[3] Detailed bank records for the period of January 2006 to November 2006 indicate that AFI used approximately $3.6 million of the $35 million raised during that period to purchase automobiles or auto receivables. AFI's March 2007 Lloyd's application states that the company has only $5.3 million in collateral for outstanding receivables, indicating that AFI has only used a small portion of the funds raised to purchase or generate auto receivables. [Oses Dec. at ¶¶ **?????????,** Exh. XXXXX Marks Dec. at ¶¶ 8 and 14, Exh. D].

¶¶ 6 and 7, Exhs. A and B] Among the personal payments Bruteyn has made through this account are: $2 million to purchase real estate through a Florida broker; $200,000 to invest in other real property; $160,000 in credit card payments; $109,000 for a divorce settlement and child support; $100,000 as a partial payment on an Aston Martin automobile; $35,000 for flooring at "Tile Land," a $30,000 payment for an airplane (Bowden is a pilot); and various amounts totaling more than $750,000 for other personal expenses such as country club dues, interior decorating services (provided by Bowden's wife), landscaping services, utilities, travel and cash withdrawals. [App. at 011, 417-419, 424-425, 427-429][Oses Dec. at ¶ 39, Exh. 43 (Rector Dec. at ¶ 6, Exh. A and B]. Bowden also received over $900,000 from Hess to purchase and remodel a Dallas home. [App. at 012, 064, 417-418, 427-429][Oses Dec. at ¶ 39(d), Exhs. 15 and 43 (Rector Dec. at ¶ 8, Exh. B].

Defendants have spent $1.4 million on commercial real estate, in part to expand its chain of automobile dealerships. [010-011, 417, 419, 423][Oses at ¶ 39(a), Exh 43 (Rector Dec. at ¶ 6, Exh. A]. They have spent approximately $2.3 million to fund business operations, including expenditures to purchase the inventory of automobiles for the used car lots. [*id.*]

AmeriFirst has placed only a fraction of funds collected from investors in secure, collateralized investments. [010, 282-412, 417, 419, 420][Oses Dec. at ¶¶ 34-35, Exhs. 31-38, 43 (Rector Dec. at ¶ 6, Exh. A]. Instead, Defendants have placed millions of dollars in such risky investments as junk-rated corporate bonds, put and call options,

common stocks in volatile industries, such as the technology sector, and floating rate funds.[4] [*id.*]

3. Misrepesentations and Omissions Concerning the Background Of AmeriFirst and Its Principals

AmeriFirst sales literature and correspondence describes the background of the company and its principals in solely positive, if not laudatory, terms. Defendants represent that AmeriFirst and its present management have been "in business for 15 years without one complaint or late payment." [App. at 0012, 017, 034][Oses Dec. at ¶¶ at 43A, 43B and 43V, Exhs. 1, 2].

AmeriFirst boasts that Bruteyn, its managing director, is a "CRCP (Certified Regulatory and Compliance Professional) from the Wharton School of Business." [App. at 012, 016, 460-461, 522 and 550][Oses Dec. at ¶ 43A, Exhs. 1; Aponte Dec. at ¶¶ 5E and 6C, 9, 13, Exh. 7, 16 and 19]. AmeriFirst describes Bruteyn as holding "Series 7, 24 and 63 securities licenses" from the NASD and further touts his experience as director of an investment banking department, where "[i]n addition to market making and brokerage activities, Mr. Bruteyn specialized in compliance issues pertaining to these activities." [App. at 003, 157-158][Oses Dec. at ¶ 10, Exh. 22];

Defendants fail to disclose to investors Bruteyn's history of financial irresponsibility and his record of securities-related sanctions. Within the past decade, once in 1998 and again in 2005, Bruteyn discharged his personal debts through a Chapter 7 Bankruptcy. [App. at 003, 188-189][Oses Dec. at ¶¶ 8 and 9, Exh. 25]. Bruteyn has been sanctioned by the NASD for numerous improprieties and, in August

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[4] The evidence demonstrates that AmeriFirst has transferred more than $9.5 million to various brokerage firms. Not only have these funds been placed in speculative investments that place investor principal at risk, these funds are earning an overall return that is significantly below the level necessary to pay the interest promised to investors. [App. at 010, 283-296, 417, 419, 420][Oses Dec. at ¶ 35, Exhs. 32 and 43 (Rector Dec. at ¶6, Exh. A)].

2003, was finally barred from association with any NASD member. [App. at 003, 004, 012-14, 000171-191, 409-408][Oses Dec. at ¶¶ 11, 12, 13 and 43, Exhs. 23, 24, 39. [App. at 004, 012-14, 000171-191]. As a consequence, contrary to AmeriFirst's claim, Bruteyn no longer holds any NASD securities licenses. Bruteyn was also the CEO of American Securities Corp., an NASD member broker-dealer whose registration was cancelled while under suspension for failing to respond to a request for financial information and failing to pay a fee. [App. at 044, 012—14, 187A-187B, 187AA-187DD][Oses Dec. at ¶¶ 14 and 43, Exh. 24]. As a consequence, contrary to AmeriFirst's claim, Bruteyn no longer holds any NASD securities licenses.

V. ONGOING ACTIVITIES AND FUTURE PROSPECTS

Defendants' offer and sale of the AmeriFirst SDOs is ongoing. AmeriFirst continues to promote the program, collect investor funds and pay commissions to its sales agents. [App. at 153-166,417-418[[Oses Dec. at ¶¶ 38, 43R, Exh. 22, 42, 43 (Rector Dec. at ¶ 7]

As a consequence of Defendants' pattern of misappropriating principal and placing client funds in investments that provide insubstantial returns, AmeriFirst investors are likely to suffer significant losses. A large proportion of AmeriFirst clients have elected to let their returns compound, rather than receiving interest payments on a monthly basis. AmeriFirst has managed to earn sufficient funds to make interest payments to non-compounding investors; it is not, however, preserving sufficient principal and earning sufficient income to meet its obligations to compounding investors when their AmeriFirst SDOs mature.

Twice in the past decade, Bruteyn has had to resort to the bankruptcy court as a consequence of his propensity to incur financial obligations that he is not prepared to

fulfill. In the absence of emergency relief, these Defendants will likely, in the near future, repeat this pattern of irresponsibility and AmeriFirst investors will suffer great financial distress and hardship. The relief requested by the Commission will circumscribe the damage to present investors, prevent others from falling prey to AmeriFirst's false and misleading claims, and enhance the ability of the Commission to provide victims with monetary relief.

VI. <u>DEFENDANTS' CONDUCT VIOLATES THE FEDERAL SECURITIES LAWS</u>

A. The Notes are Securities

1. The SDOs are "notes" as Defined in the <u>Securities Act and Exchange Act</u>

The SDOs are securities under Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act, both of which expressly include "notes" in their definitions of "security." In *Reves v. Ernst & Young*, 494 U.S. 56 (1990), the Supreme Court adopted the "family resemblance" test to determine whether particular notes constitute a security. This test presumes that every note is a security. An issuer can rebut this presumption by showing that a particular note "bear[s] a strong family resemblance" to a list of notes the Court deemed not to be securities. *Id.* at 65.

Reves lists four considerations to determine whether a note is a security: 1) the motivation of the buyer and seller; 2) the plan of distribution in order to determine whether the note is intended for speculation or investment; 3) the reasonable expectations of the investing public; and 4) whether there is any risk-reducing factor, such as the presence of another regulatory scheme. *Id.* at 66-70. Applied here, these factors demonstrate that the SDOs are securities. First, if the seller's motivation is "to raise money for the general use of a business enterprise ... and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a

'security.'" *Id.* at 66. AmeriFirst, despite the representations in offering materials, has used offering proceeds for general business purposes, including purchasing used car lots and funding their operations. Second, AmeriFirst indiscriminately sells the SDOs to investors across the country, through a network of solicited agents, without regard for investors' accredited status or the suitability of the SDOs. [App. at 437][Aponte Dec. at ¶ 16]. This plan of distribution strongly suggests that the SDOs are securities. *See Pollack v. Laidlaw Holdings, Inc.*, 27 F.3d 808, 813 (2d Cir. 1994) (broad-based, unrestricted sale of notes suggests that they are securities). Third, the SDOs plainly involve the investment of money with a corresponding expectation of profit. Fourth, there is no other regulatory scheme that significantly reduces the risk of the SDOs, and the purported insurance coverage provides scant, if any, protection. *See Marine Bank v. Weaver*, 455 U.S. 551 (1982); *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979). Indeed, it is the very lack of another regulatory scheme that has allowed AmeriFirst to raise large sums without providing accurate or complete disclosures to prospective investors. Therefore, the SDOs are securities.[5]

2. The SDOs are also "investment contracts"

The SDOs are also "investment contracts," which are securities under Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act. An investment contract is (1) an investment of money (2) in a common enterprise (3) with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. *See SEC v. Edwards*, 540 U.S. 389, 393 (2004); *SEC v. W.J. Howey Co.,* 328 U.S. 293, 301 (1946). The Supreme Court has emphasized that the touchstone

[5] The short-term note exceptions under the Securities Act and the Exchange Act are inapplicable because, among other reasons, the SDOs have one to five year terms.

of an investment contract is the "presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975). This definition "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek to use the money of others on the promise of profits." *Edwards*, 540 U.S. at 393 (*quoting Howey*).

The SDOs satisfy *Howey's* three prongs. The first prong was satisfied when investors gave AmeriFirst money.

To establish *Howey's* second prong, the "common enterprise" element, most circuits require either horizontal or vertical commonality. *See SEC v. R.G. Reynolds Enters., Inc.*, 952 F.2d 1125, 1130 (9th Cir. 1991). "Horizontal commonality" requires an enterprise common to a group of investors, such as a pooling of investor assets, by which their fortunes are linked. *Id.* "Vertical commonality" requires that investor success be linked to the promoter's success. *See SEC v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). The Fifth Circuit, where the staff will file this action, mandates "broad vertical commonality," which requires only that investors' fortunes be linked to the efforts or expertise of the promoter. *See Long v. Schultz Cattle Co.*, 881 F.2d 129, 140-41 (5th Cir. 1989).[6]

Both forms of commonality exist here. Horizontal commonality exists because investor proceeds are pooled and used to pay for AFI's operations and the stated goal of obtaining auto notes. Vertical commonality exists because investors' fortunes are linked with those of AmeriFirst.

As for the third prong, investors assumed a purely passive role in the investment

with AmeriFirst. They expected to receive annual returns of 7% to 8%, based solely on AmeriFirst's ability to loan money to car buyers or purchase automobile notes. Beyond making funds available, no investor was required to put forth any effort to generate profits. *See SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 483 (5th Cir. 1984) (third *Howey* prong satisfied when "the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise").

B. Registration Violations: Sections 5(a) and 5(c) of the Securities Act

Absent an exemption, Section 5(a) of the Securities Act prohibits any person from selling a security in interstate commerce without an effective registration statement. Further, Section 5(c) prohibits offers to sell a security unless a registration statement for the offering has been filed with the Commission. A *prima facie* case for a violation of these provisions is established by showing 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 Chemical Co.*, 612 F.2d 896, 901-02 (5th Cir. 1980). Once a *prima facie* violation is established, the defendants bear a heavy burden of proving an exemption to registration, *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953), since courts construe such exemptions narrowly to further the Act's purpose "[t]o provide full and fair disclosure of the character of the securities ... and to prevent frauds." *SEC v. Murphy*, 626 F.2d 633, 641 (9th Cir. 1980).

AmeriFirst and its principals violated the registration provisions because they directly offered and sold, through interstate facilities or the mails, securities to which no

registration statement or registration exemption applied. For purposes of determining the applicability of registration exemptions, AFI and AAC should be treated as one issuer. The following factors are considered in determining whether issuers are subject to integration: (1) common control among the issuers; (2) a disregard for entity form; (3) the issuers are engaged in the same type of business; and (4) co-mingling of assets among the issuers. *Equity Programs Investment Corp.*, 1978 SEC No-Act. Lexis 2236 (Nov. 28, 1978); *Rathbone, King & Seeley, Inc.*, 1987 SEC No-Act. Lexis 1982 (Apr. 20, 1987); Sec. Act. Rel. No. 33-4552 (Nov. 6, 1962).

Here, Bruteyn and Bowden control both companies and run them as a single enterprise. Both are in the same business and offer SDOs to investors. The SDO proceeds from both companies are co-mingled into common accounts. Therefore, AFI and AAC are subject to issuer integration.[7]

Turning to the exemptions, the Section 3(a)(11) and Rule 147 exemptions are unavailable because they are limited to purely in-state offerings and AmeriFirst offered and sold the SDOs in at least two states. The "private placement" exemption of Section 4(2) of the Securities Act likewise is inapplicable. Availability of this exemption turns on

[7] The SDO offering constitutes a single, continuous offering under Rule 502(a) of Regulation D and for the purposes of the Section 4(2) "private placement" exemption. The factors relevant to this determination are (1) whether the offering is part of a single plan of financing; (2) whether the offering involves issuance of the same class of securities; (3) whether the components of the offering were made at or about the same time; (4) whether the same kind of consideration is to be received; and (5) whether the components of offering are made for the same general purpose. *See* Note to Rule 502, citing Securities Act Rel. No. 4552 (Nov. 6, 1962); *see also Murphy*, 626 F. 2d at 645. Rule 502(a) of Regulation D identifies the same factors for consideration in determining whether offers and sales should be integrated for purposes of exemptions under Regulation D, except that in each of the five factors the focus is on sales rather than offerings. 17 C.F.R. § 230.502(a), *citing* Securities Act Release No. 4552. Here, the SDOs were offered ostensibly to fund a common business enterprise, namely, AFI's auto loan purchasing program. The SDOs, regardless of what Bruteyn and Bowden named them, are identical in all material respects. The offering has been continuous, and sought the same consideration: cash. Therefore, AmeriFirst conducted an integrated offering.

four factors: (1) the number of offerees and their relationship to each other and to the issuer; (2) the number of units offered; (3) the offering size; and (4) the manner of the offering. *Murphy*, 626 F.2d at 644; *Doran v. Petroleum Mgmt. Corp.*, 545 F.2d 893, 899 (5th Cir. 1977). AmeriFirst and its principals have sold and are selling the SDOs to hundreds of investors in at least two states, raising at least $34 million. None of these investors appear to have had any relationship with AmeriFirst or its principals before investing, and AmeriFirst has made little effort to determine investor suitability or sophistication. [Aponte Dec. at ¶ 16]. AmeriFirst simply accepts money from anyone willing to invest. In addition, AmeriFirst uses the internet and a network of sales agents, who place newspaper advertisements, to obtain investors. This use of the internet and newspaper ads constitutes a general solicitation, and strongly identifies the offering as public rather than private. Therefore, Section 4(2) is inapplicable.

Regulation D exemptions do not apply either. The amount raised through the integrated offering far exceeds the $1 million limitation in Rule 504 and the $5 million limitation in Rule 505. Rule 505 and 506 exemptions are unavailable because AmeriFirst has offered the SDOs through general solicitation, and because non-accredited offerees (of which there appear to be many) were not provided financial statements or other information required in a registration statement filed under the Securities Act, as required by Rule 502(b)(2). Rule 506 does not apply for the additional reason that it requires each non-accredited investor or his representative have "such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to his making any sale that such purchaser comes within this description." It

appears that many SDO investors do not meet these criteria,[8] and, in any event, AmeriFirst has not attempted to determine investors' business or financial knowledge or experience.

Finally, the Section 4(6) exemption, for offerings of up to $5,000,000 to accredited investors, is available only "if there is no advertising or public solicitation in connection with the transaction by the issuer or anyone acting on the issuer's behalf." AmeriFirst raised well over $5 million, has effected a general solicitation, and has offered and sold SDOs to unaccredited investors. This renders Section 4(6) inapplicable.

B. Antifraud Violations: Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

Section 17(a) of the Securities Act prohibits employing fraudulent schemes or making material misrepresentations or omissions in the offer or sale of securities. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibits the same conduct if committed in connection with the purchase or sale of securities. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976). A violation of these provisions requires that the alleged misrepresentations or omissions be material. Information is material if a reasonable investor would consider it significant to making an investment decision. *Basic v. Levinson*, 485 U.S. 224, 230 (1988).

Actions under Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder also require proof of *scienter*, *Aaron v. SEC*, 446 U.S. 680, 691 (1980), a "mental state embracing intent to deceive, manipulate or defraud." *Hochfelder*, 425 U.S. at 193. Actions under Sections 17(a)(2) and 17(a)(3) of

[8] Most SDO investors appear to be senior citizens, unsophisticated in business and finance, who are uncertain as to what they actually purchased from AmeriFirst. [App. at 434][Aponte Dec. at ¶ 8].

the Securities Act require no such a showing. *Aaron*, 446 U.S. at 691. *Scienter* is established by showing by a preponderance of the evidence that the defendants acted intentionally or with severe recklessness. *See, e.g.*, *Broad v. Rockwell Int'l Corp.,* 642 F.2d 929, 961-62 (5th Cir.), *cert. denied*, 454 U.S. 965 (1981). Courts have also held that the fact that a principal spends investor funds on personal expenses establishes the requisite state of mind for committing securities fraud. *Id; see also, Lowry v. SEC*, 340 F.3d 501, 506 (8th Cir. 2003); *SEC v. Infinity Group Co.*, 212 F.3d 180, 192-93 (3d Cir. 2000). The *scienter* of a company's management is imputed to the company. *See, e.g., SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972).

As outlined above, AFI, AAC, Bruteyn, Bowden made numerous misrepresentations and omissions to entice investors into purchasing the SDOs. These misrepresentations and omissions were material, going to the very heart of the investment, such as the safety of the investment, ability to generate investor returns and use of investor proceeds. In the offering documents and agreements, AmeriFirst misrepresented its status as a bank, the true status of insurance coverage, the uses of investor funds and the past financial successes of AmeriFirst and Bruteyn. Moreover, Bruteyn and Bowden misappropriated millions in investor funds for his personal use, spending lavishly on homes, cars, country clubs and travel. These facts demonstrate that Bowden and Bruteyn acted with a high degree of *scienter*, which is imputed to AFI and AAC.

VII. THE RELIEF SOUGHT BY THE COMMISSION IS NECESSARY AND APPROPRIATE

A. Temporary Restraining Orders and Preliminary Injunctions are Necessary and Appropriate

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). *Ex Parte* relief is appropriate when notice to the opposing party could render fruitless further prosecution of the action. *First Technology Safety Systems, Inc. v. Depinet,* 11 F.3d 641, 650-51 (6th Cir. 1993). Defendants currently hold millions of dollars in liquid assets; given notice, these assets could be hidden rapidly.

When the Commission has established a *prima facie* showing of violations and the likelihood that such violations will continue, issuance of a TRO and order of 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). A TRO and permanent injunction is further justified against such violative conduct when there exists a reasonable likelihood the defendant will continue to violate the law. *See SEC v. Zale Corp.*, 650 F.2d 718, 720 (5th Cir. 1981); *SEC v. Blatt*, 583 F.2d 1325, 1334.

Unlike private litigants, the Commission is not required to show a risk of irreparable injury or a balance of equities in its favor. *SEC v. Management Dynamics, Inc.*, 515 F.2d 801, 808 (2d Cir. 1975); *Unifund*, 910 F.2d 1028, 1036 (2nd Cir. 1990).

> [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)).

As set forth above, there is a substantial likelihood that the Commission will succeed on the merits. The evidence demonstrates that Defendants have repeatedly violated the antifraud provisions of the federal securities laws. The evidence also establishes that Defendants have repeatedly violated Section 5 of the Securities Act by engaging in the offer and sale of securities without registration.

The likelihood that a defendant will repeat violative conduct is measured by the totality of the circumstances, including, among other things, the degree of *scienter*, the repetitiveness of his violative conduct, and the opportunity his occupation affords to repeat the violative conduct. *SEC v. Commonwealth Chemical Sec., Inc.*, 574 F.2d 90, 99-101 (2d. Cir. 1978) (assessing likelihood of future violations warranting permanent injunction). All these factors call for preliminary injunctive relief against the Defendants in this matter.

First, as set forth above, each of the Defendants exhibited a high degree of *scienter*. Each defendant committed securities laws violations knowingly and with the intent to defraud AmeriFirst clients.

Second, the conduct of the Defendants was repetitive. The fraudulent scheme has been ongoing for at least one and one-half years and victimized more than 300 investors. All of the defendants have continued their fraudulent behavior through the present. Such "fraudulent past conduct gives rise to an inference of a reasonable expectation of continued violations." *SEC v. Manor Nursing,* 458 F.2d at 1100.

Third, Bruteyn, AmeriFirst's Managing Director, has a substantial history of misconduct before the commencement of the present scheme. Bruteyn record accentuates the probability that Defendants will continue to violate the federal securities laws unless restrained and enjoined.

Under these circumstances, use of the Court's board equitable powers is justified. The Defendants should be temporarily and preliminarily enjoined.

B. An Asset Freeze is Necessary and Appropriate

An immediate asset freeze is necessary, pending final judgment. Part of the relief the Commission seeks is an order requiring the defendants to disgorge their ill-gotten gains. A disgorgement order can be rendered uncollectable and thus meaningless, however, unless a freeze is imposed to prevent the defendants from secreting or dissipating assets prior to final judgment. *SEC v. Manor Nursing Ctrs*, *Inc*. 458 F.2d 1082, 1106; *Commodity Futures Trading Commission v. Muller*, 570 F.2d 1296, 1300-01 (5th Cir. 1978). In addition, where defendants' conduct involves fraud, and there is the risk of asset depletion, a freeze is particularly warranted. *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d at 1106 ("Because of the fraudulent nature of appellants' violations, the court could not be assured that appellants would not waste their assets prior to refunding public investors' money"). *See also SEC v. American Board of Trade, Inc.*, 645 F. Supp. 1047, 1051 (S.D.N.Y. 1986), *modified on other grounds*, 830 F.2d 431 (2d Cir. (N.Y.) 1987), *cert. denied*, 485 U.S. 938 (1988) (imposing freeze to prevent depletion of assets).

The evidentiary showing needed to justify an asset freeze is less than the showing needed to justify a preliminary injunction, because injunctive relief raises the specter of future liability for contempt, while an asset freeze only preserves the *status quo*. SEC v. *Unifund*, 910 F.2d at 1039. Thus, especially since the record establishes a strong *prima facia* case of egregious fraud, and since the record shows solid grounds for preliminary injunctive relief, the record warrants an asset freeze in light of the evidence showing it is needed to prevent assets from being dissipated prior to final judgment.

Moreover, the funds or assets affected by the freeze need not be traceable to the illegal activity. *Id.* at 1041. *See also SEC v. Grossman*, 887 F. Supp. 649, 661 (S.D.N.Y. 1995).

The Commission has identified approximately $30 million in assets, most of which are highly liquid, that the Defendants and Relief Defendants may dissipate or move to offshore accounts if an asset freeze and emergency injunctive relief are not obtained. Hess Financial already has sent money to an existing account in the Bahamas, and it appears to have recently purchased property in the Caribbean.

Here, the nature of Defendants' violations shows that they cannot be trusted to pay what they owe. Unless an asset freeze is imposed on these Defendants immediately, they are likely to continue to dissipate investors' money or transfer assets abroad. In these circumstances, Defendants' assets must be frozen to prevent further dissipation of money and real and personal property remaining in the United States that will be needed to satisfy a final judgment of disgorgement in the future.

The Court should also freeze assets of Relief Defendants that are derived from the fraudulent conduct alleged in the Commission's Complaint. As set forth above, each of the Relief Defendants is closely related to Bruteyn and Bowden and has received millions of dollars of investors monies and/or have title to property that was likely purchased with investor funds. These funds and assets may represent a significant portion of the proceeds recoverable for the benefit of defrauded investors.

The Commission is entitled to equitable relief from parties who are not charged with wrongdoing where they "possess illegally obtained profits but have no legitimate claim to them." *SEC v. Cherif*, 933 F.2d 403, 414, n. 11 (7th Cir. 1991), *cert. denied*, 502 U.S. 1071 (1992). Consequently, it is not necessary for the person holding the

property to have done anything wrong in order for that person to be required to return property to its rightful owner. As recognized by the court in *United States v. Cannistraro*, 694 F. Supp. 62, 72, n. 11 (D.N.J. 1988), "[t]he courts impose the remedy of constructive trust where, rightfully or wrongfully, a party has obtained property which unjustly enriches him." (emphasis supplied), *modified*, 871 F.2d 1210 (3rd Cir. 1989). *Accord Rolins v. Metropolitan Life Insurance Co.*, 863 F.2d 1346, 1354 (7th Cir. 1988) ("a constructive trust may be invoked even where the unjustly enriched party is completely blameless"). Accordingly, the Commission requests that the asset freeze and other equitable relief be extended to these Relief Defendants.

C. Orders Requiring Accountings and Preserving Records Are Necessary and Appropriate

In order to effectuate completely a freeze of Defendants and Relief Defendants' assets, an accounting of all of their assets and of the funds they received from the investors is also necessary. To determine accurately the scope of a defendant's fraud and ability to return illegal profits, courts frequently require an accounting of all money or property obtained as a result of the fraudulent activity set forth in the Commission's complaint, as well as his current financial resources or assets. *See, e.g., Manor Nursing Ctrs., Inc.*, 458 F.2d at 1105. Given the amount of investor funds involved in this matter and the magnitude of the misappropriation and misuse of funds, an accounting is particularly appropriate. Accordingly, the Commission requests an order requiring all Defendants and relief defendants to provide a comprehensive accounting of their current assets and all assets obtained from June 1, 2005 to date.[9]

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[9] While the Commission can conclude from the documents it currently possesses that the scheme was in existence by no later than January 2006, it cannot rule out the possibility that the fraudulent activity began earlier. The Commission does not have the documents necessary to specify when the Defendants launched the offer and sale of the SDOs. For example, the Commission does not have bank records for the period prior to January 2006.

Furthermore, the Commission requests an order prohibiting Defendants from altering, removing or destroying their books and records in order to preserve the body of evidence for review by this Court. In light of level of deceit practiced by Defendants, they cannot be trusted to preserve and produce without the threat that destruction of books and records will constitute an immediate act of contempt. Furthermore, these books and records are crucial to the Receiver's mission to locate and collect assets for the benefit of the victims of Defendants' fraud.

D. <u>A Repatriation Order is Necessary and Appropriate</u>

The Commission also seeks a repatriation order requiring that the Defendants and Relief Defendants return to identified accounts in the United States, all monies they have outside this Court's jurisdiction that is subject to the asset freeze and Receivership. Such equitable relief is especially appropriate where the Commission is seeking an accounting and disgorgement in its prayer for relief as in the case at bar. *SEC v. R.J. Allen & Assoc., Inc.*, 386 F. Supp. 866, 880-881 (S.D. Fla. 1974).

Defendants and Relief Defendants control at least one international bank account that has already been used to misappropriate investor funds and could facilitate efforts to hide assets in the future. The evidence indicates that Bruteyn, though Hess, maintains a bank account at First Caribbean International Bank through Meridian Trust Company Limited. [Oses Dec. at ¶ 42, Exh. 17]. The evidence also demonstrates that Hess utilized this account to wire over $1 million to pay apparent commissions to Florida sales agents. [Oses Dec. at ¶ 42, Exh. 18]. In addition, Bruteyn, through Hess, appears to have used the account to purchase real property in Montserrat. [App. at 012, 065-077][Oses Dec. at ¶ 42, Exh. 16]

As the Commission's has not received complete bank records at the time of this Memorandum, there is a high probability that additional investor funds have been sent to foreign destinations or used to purchase assets abroad. These assets must be brought within the jurisdiction of this Court to conserve them for investor relief as this case litigation proceeds.

E. <u>Appointment of a Receiver is Appropriate</u>

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. Materia,* 745 F.2d 197 (2d. Cir. 1984); *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 Temporary 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); *United States v. Mansion House Center N. Redevelopment Co.,* 419 F. Supp. 85, 87 (E.D. Mo. 1976).

The evidence presented here establishes that Defendants have misused substantial sums of investor funds and that are holding an enormous amount of cash and other assets that are at risk of disappearing any moment. Moreover, the Relief Defendants and other third parties received millions of dollars in cash and property likely derived from the investor funds fraudulently obtained and misappropriated by Defendants; and they still have assets traceable to the fraud which the Commission may

claim on behalf of investors. Under these circumstances, appointment of a receiver to marshal and conserve defendants' property and other property traceable to their fraud is essential to providing meaningful restitution to investors.

F. Expedited Discovery is Necessary and Appropriate

The Federal Rules of Civil Procedure give District Courts discretion to permit expedited discovery. Defendants are usually given until at least 45 days after the service of a summons and complaint to respond to document requests, Fed. R. Civ. P. 34(b), and 30 days after such service to appear for a deposition, Fed. R. Civ. P. 30(a) or respond to interrogatories, Fed. R. Civ. P. 33(a). Each of these Rules provides, however, that the Court, in its discretion, may shorten these periods. *See also Gibson v. Bagas Restaurants, Inc.,* 30 Fed. R. Serv. 2d 792, 87 F.R.D 60 (W.D. Mo. 1980) (accelerated discovery is allowable within the discretion of the Court). Moreover, where urgent relief is sought and expedited discovery is needed to accomplish that result, a court may grant accelerated discovery. *See Notaro v. Koch*, 35 Fed. R. Serv. 2d 580, 95 F.R.D. 403 (S.D.N.Y 1982).

Expedited discovery is required in this case to enable the Commission more fully to develop the evidence prior to the conduct of a preliminary injunction hearing. The Commission should have the opportunity to supplement the record prior to the preliminary injunction hearing.

VII. CONCLUSION

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

Dated and signed on the ___ day of ________________ 2007

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