

COMMONWEALTH OF MASSACHUSETTS  
OFFICE OF THE SECRETARY OF THE COMMONWEALTH  
SECURITIES DIVISION  
ONE ASHBURTON PLACE, 17th FLOOR  
BOSTON, MASSACHUSETTS 02108

IN THE MATTER OF:

SECURITIES AMERICA

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)  
) Docket No. 2009-0085  
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)

ADMINISTRATIVE COMPLAINT

I. PRELIMINARY STATEMENT

The Enforcement Section of the Massachusetts Securities Division of the Office of the Secretary of the Commonwealth (respectively, the "Enforcement Section" and the "Division") files this complaint (the "Complaint") in order to commence an adjudicatory proceeding against Securities America, Inc. ("Respondent") for violating M.G.L. c. 110A, the Massachusetts Uniform Securities Act (the "Act"), and 950 CMR 10.00 *et seq.* (the "Regulations"). The Complaint is based on Respondent's material omissions and misleading statements made by Respondent in the sale of approximately 697 million dollars of promissory notes issued by special purpose corporations ("SPCs") wholly owned by Medical Capital Holdings, Inc. (All Medical Capital Holdings, Inc. entities will be referred to collectively as "Medical Capital" and all Medical Capital notes as "MC Notes").

The Enforcement Section seeks an order (a) requiring Respondent to permanently cease and desist from committing any further violations of the Act and Regulations, (b)

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requiring Respondent to provide restitution to all Massachusetts investors whom Respondent sold MC Notes to in an amount that a Hearing Officer deems appropriate, (c) censuring Respondent, (d) requiring Respondent to pay an administrative fine in an amount and upon such terms and conditions as a Hearing Officer may determine, and (e) taking any other action that a Hearing Officer may deem appropriate in the public interest and necessary for the protection of Massachusetts investors.

## II. SUMMARY

### *Background*

Respondent is a registered broker dealer and subsidiary of Ameriprise Financial, Inc. Respondent acted as the placement agent for the sale of MC Notes from 2003 until 2008. Medical Capital's business model included raising funds by issuing promissory notes, which would then be used to purchase batches of medical receivables to be held in trust for each SPC which issued the MC Notes. The MC Notes were offered in a series of private placements under a Rule 506 exemption of Regulation D. The purpose of a Regulation D exemption is to allow for the sale of unregistered securities to sophisticated and accredited investors without generally soliciting the securities to the public. Therefore, securities sold pursuant to a Regulation D exemption are often referred to as "private placement securities". As private placement securities, MC Notes are prohibited from being offered to the general public, since some members of the public cannot bear the risk of investing in such unregistered securities.

Medical Capital issued over 1.7 billion dollars in MC Notes from 2003 to 2009. Respondent acted as one of the placement agents in connection with the sale of 37% of the total MC Notes issued, which amounts to 697 million dollars. Respondent sold MC

Notes to over 60 Massachusetts investors who purchased approximately 7.2 million dollars of MC Notes. In connection with these sales, Respondent received over 26 million dollars in compensation. In addition, Respondent's top executives enjoyed a number of vacation trips such as golfing in Pebble Beach and stays in Las Vegas resorts, which were paid by Medical Capital.

Since August of 2008, Medical Capital has defaulted on all of its outstanding note obligations and is currently in permanent receivership leaving millions of dollars of investors' life savings frozen and illiquid. Today, 1.079 billion dollars of MC Notes are in default status, of which 358 million dollars were sold by Respondent.

### ***Investigation***

In December 2009, the Division received a number of calls from Massachusetts investors regarding the sales of MC Notes by Respondent. Based on these complaints, the Division initiated an investigation. The investigation revealed that Respondent failed to reasonably act on information they held regarding the risks associated with MC Notes and also withheld that material risk information from investors.

Unsophisticated investors placed their life savings into MC Notes in reliance on Respondent's recommendations that such investments were suitable. However, all material risks and information regarding MC Notes were not disclosed to investors. These risks were known to Respondent. Year after year, the due diligence analyst, retained by Respondent to conduct a review of the various Medical Capital offerings, specifically requested and at many times pleaded that investors be informed of certain heightened risks.

The Division in its deposition of the Respondent's Chairman of the Due Diligence Committee and Head of Sales, Thomas Cross, asked why certain information, recommended to be given to investors by the due diligence analyst, was not provided to investors. Mr. Cross responded that giving such information to investors, specifically the due diligence analyst reports, would be a "bad thing".

Investors were also told by Respondent that MC Notes were "Fully Secured" and as such, investors continued to pour their life savings into the MC Notes amounting to hundreds of millions of dollars. All the while, material risk information which would have made clear to investors the high risk associated with the MC Notes was kept hidden from them.

***Promises Made by Respondent***

Documents provided to investors stated that "...the undersigned placement agent [Respondent] has reasonable grounds to believe that an investment in the notes of the company is suitable for the subscriber..." and that "...the undersigned placement agent has informed the subscriber of...all pertinent facts relating to an investment in the notes..." In reality, Respondent did not inform investors of "all pertinent facts relating to an investment in the notes" but instead withheld material information associated with the MC Notes during a period of five years. Respondent claims to have heavily relied on outside due diligence analyst reports to approve the sale of MC Notes, yet year after year, Respondent ignored the material risks and disclosure recommendations raised by such reports.

### ***Marketing & Sale of MC Notes***

Respondent's registered representatives circulated marketing materials to investors for the purpose of soliciting sales of MC Notes without first ensuring that each investor was sophisticated and accredited. One of Respondent's representatives testified to the Division that he held a number of dinner seminars where 80-100 potential investors would attend to hear about Medical Capital. Attendees of this dinner were not asked if they were accredited and sophisticated investors prior to being exposed to the seminar on Medical Capital's note offerings. In fact, attendees, some of whom were not even customers of this registered representative, were able to simply walk up to a table and pick up marketing materials on this "private" placement security without signing or filing out any form to ensure their sophistication and accreditation status.

Respondent's representatives also utilized flyers, pamphlets and letters which discussed MC Notes. These materials, which contained interest rate information and held the notes out as being "Fully Secured", were sent to investors without ensuring beforehand that each investor who received such information was sophisticated and accredited.

Over four hundred of Respondent's registered representatives sold MC Notes by utilizing private placement memorandums ("PPM"), several marketing flyers and pamphlets. MC Notes were characterized as "secured" notes in both the Medical Capital PPMs and the flyers and pamphlets used by Respondent.

Many Massachusetts investors informed the Division that they did not understand how the MC Notes were structured. When asked to explain the MC Notes, many investors informed the Division that they simply relied on their registered

representatives' recommendations and the due diligence that Respondent had conducted on Medical Capital. A majority of the Massachusetts investors who purchased MC Notes from Respondent are unsophisticated investors that do not have experience in investing in high risk products.

Additionally, a number of investors in Massachusetts, who purchased MC Notes from Respondent, actually thought the notes were a safe investment that had a low risk of losing its principal and interest. Investors also perceived the fact that MC Notes were held out to be "secured" as indicia that the notes held a low risk. A number of Massachusetts investors purchased MC Notes because they were held out by the Respondent as offering monthly, quarterly or annual interest payments. Certain Massachusetts investors placed their retirement savings into MC Notes on the basis of obtaining interest payments as a source of fixed income. In one piece of marketing material, approved for circulation by Respondent's compliance department, investors were informed that MC Notes are "The Missing Piece That Should Be Included In Your Fixed Income Arsenal!". Yet in reality MC Notes were a very speculative security that should have only been sold to sophisticated investors who could risk losing their entire investment.

***Due Diligence Reports Ignored & Materials Withheld from Investors***

Respondent utilized an internal Due Diligence Committee consisting of top Securities America executives to approve new products on its platform. Respondent's Due Diligence Committee reviewed and approved six Medical Capital offerings from 2003 until 2008. In connection with its review, the Due Diligence Committee utilized an outside due diligence analyst to review each note offering. In testimony before the

Division, Respondent's Chairman of the Due Diligence Committee stated that the Committee relied on three sources of information: 1) each offering's PPM; 2), third party analyst due diligence reports; and 3) information obtained from meetings and conferences with Medical Capital. From 2003 until 2008 the same due diligence analyst generated all of the due diligence reports which were given to Respondent prior to the sale of each series of MC Notes. Mr. Cross further testified that the most heavily relied on source of information were the due diligence analyst reports. Yet the Due Diligence Committee actually ignored and failed to alert investors of the risk issues contained within the due diligence analyst reports from 2003 until 2008. Respondent failed to address any of the recommendations raised by the due diligence analyst and purposely chose to withhold the actual reports from investors.

***Material Risk Issues Raised from 2003 - 2008***

From 2003 until 2008, Respondent obtained due diligence reports each year from the same analyst which reviewed the Medical Capital offerings. In each of the due diligence analyst reports a number of material risks were raised. Respondent failed to take reasonable steps in addressing these material risks with Medical Capital and instead chose to accept whatever explanation Medical Capital provided. Additionally, Respondent never informed investors that a due diligence analyst had been raising a number of issues as material risks. Further, Respondent, after being strongly recommended by the due diligence analyst to provide investors with a disclosure of the material risks, chose not to do so.

In 2003, the due diligence analyst issued a report on Medical Capital's offering and recommended to Respondent that all year-end income statements and balance sheets

be attached to the PPMs. Also, the report stated that all material litigation be disclosed, and that Medical Capital provide investors with information to track the ratio between the assets held and the notes issued (called “collateral coverage ratio”). Respondent approved the Medical Capital offering in 2003 without giving investors any of the information which the due diligence analyst recommended be provided to investors and representatives. Respondent had in its possession the financial income statements for Medical Capital entities in 2003, yet chose not to share that material information with investors and even refused to share them with its own representatives.

In 2004 the due diligence analyst report contained the same concerns and issues raised in the 2003 report. Yet Respondent again approved the MC Notes without disclosing to investors any of the material information recommended by the due diligence analyst and without asking Medical Capital to alter its PPM to include such information.

Additionally, in 2005 the due diligence analyst included another item of concern: Medical Capital’s lack of audited financials. Even though Medical Capital issued over 1.7 billion dollars in securities, it was never subject to audited financials. Meaning, none of the information provided by Medical Capital regarding the value of the assets it purchased or the amount of debt it held was ever verified by an accountant as being accurate. The lack of audited financials was highlighted as a risk by Respondent’s own President and voting member of the Due Diligence Committee, Jim Nagengast in 2005. Mr. Nagengast wrote an email in 2005 to Mr. Cross (Chairman of the Due Diligence Committee) and stated:

**My big concern is the audited financials.** At this point, there is no excuse for not having audited financials....it is a cost they simply have to bare to offer product through our channel.



We simply have to tell them that if they don't have financials by XXXX date we will stop distributing the product on that date. Then they can decide if its worth spending \$50,000 to have it done. If they won't spend the money, **that should give us concerns.**

(Emphasis Added)

Respondent ignored its President's recommendation and continued selling hundreds of millions of dollars of MC Notes without audited financials ever being conducted on any Medical Capital entities.

From 2005 until 2007, the material risks raised in the due diligence analyst reports increased dramatically. In the "Conclusions & Recommendations" section, the due diligence analyst every year from 2005 until 2007 raised the same issues as he did in 2003 and 2004. Additionally, beginning in 2005 the due diligence analyst also raised a number of added material risks associated with MC Notes. For example, in 2006 the following was recommended to Respondent regarding the MC Notes:

Furthermore, you should **strongly consider that prospective investors review and acknowledge receipt of this report to understand the material risks associated with MPFC IV** as compared to prior MCC offerings, including:

1. The Note Agreement **does not require a sinking fund** for payment of the notes or require the maintenance of any particular financial ratios to better ensure future repayment of the Notes;
2. The ability to invest up to \$50,000,000 in equity securities of all types of business and make mortgage loans to receivables sellers or other parties in health care industry, outside of MCC core expertise, and **inadequate PPM disclosures regarding mortgage financing, conflicts of interest as dual lender and commercial real estate risks;**

3. No independent directors, especially given the myriad of related and conflicted transactions and contractual relationships by and among the Company, MCC, MCH and MediTrack;
4. The executives of MCC, MR. Field and Mr. Lampariello, **have not agreed to personally certify** monthly net collateral coverage and with individual indemnity directly to Noteholders;
5. A diluted Note Agreement with Wells, including lack of disbursing agent function, a higher 50% threshold for Noteholders to enforce remedies, and the general lack of responsibility and oversight that was incorporated in prior offering;
6. Given the burgeoning size and presence of MCC and the special purpose entities and the dollars involved, **use of a local CPA firm rather than one of the nationals;** and
7. The ability of MPFC IV to purchase receivables that are greater than 180 days, **which is inconsistent with MCC's prior strategic approach** of buying quality insurance company and government receivables, which "turn" every 90 days.

(Emphasis Added)

As with all prior warnings, Respondent ignored the due diligence analyst's pleas to warn investors. Mr. Cross (Chairman of Respondent's Due Diligence Committee) testified that the due diligence analyst reports were never given to investors even after the due diligence analyst himself made that request. Mr. Cross further testified that he did not consider any of the issues raised in the 2006 due diligence report to be concerns that needed to be addressed at all. In fact, in 2006 Respondent's Due Diligence Committee approved the Medical Capital note offering in 2006 the same day it received the due diligence analyst report.

It was that year, 2006, that the due diligence analyst not only asked Respondent to give investors his report so that material risks associated with Medical Capital can be highlighted to investors, but also created a Client Disclosure Form. The Client Disclosure Form highlighted six of the seven risks raised above in the due diligence analyst report of 2006 and asked Respondent to ensure that each investor sign and acknowledge receipt of the Client Disclosure Form prior to investing in MC Notes.

Medical Capital, also received the due diligence analyst report and the Client Disclosure Form created by the due diligence analyst. In response to the Client Disclosure Form, Medical Capital commented and responded to each of the six risk issues raised in the Client Disclosure Form. Respondent did not take any action to independently investigate or review the validity of Medical Capital's responses even after the due diligence analyst deemed Medical Capital's responses to be "BS". Additionally, Respondent chose not to disclose the Client Disclosure Form to investors even after some members of Respondent's Due Diligence Committee recommended that the Client Disclosure Form and Medical Capital's responses be disclosed to investors. Respondent never provided information to investors regarding any of the heightened risks raised in the Client Disclosure Form but simply relied on investors to find their scant existence in the Medical Capital PPMs.

In an e-mail, addressed to Medical Capital and forwarded to Mr. Cross, the due diligence analyst expresses his dismay with Medical Capital's responses to the Client Disclosure Form and states:

**Fred, I disagree with every point and nothing in MPFC IV has changed structurally. It is very unfortunate that you have the ability to enhance this offering but see fit to peel off the cash every month. For \$250 million if BNY**

wants to do nothing in its capacity that doesn't prevent you from appointing an independent audit person or firm to actually accomplish oversight for investors. Nothing similarly prohibits you from leaving some of the cash in a sinking fund to provide extra measure of security. Joey told me last time either he or Sid would personally certify the CCR at 1:1 or better every month; I even drafted a certification to use which never was implemented. I could go on and on but **if you guys figure "the money keeps rolling in, why not do anything?"**, then that's certainly your business decision. (Emphasis Added).

Mr. Cross testified that no action was taken by Respondent after receiving such an email.

In fact, no action was ever taken by Respondent in regards to any of the issues raised by the due diligence analyst from 2003-2008.

The due diligence analyst was so concerned for the investors' safety that he recommended that if the material risks disclosed in the due diligence analyst reports and later the Client Disclosure Form were not given to investors, that the Respondent at least set some restriction on investors' potential losses. In an e-mail addressed directly to Respondent's Due Diligence Committee dated November 30<sup>th</sup>, 2006, the due diligence analyst stated:

...As I stated to both of you, none of the recommended changes from MPFC III were implemented, including simple definitional problems in the Administrative Service Agreement. It also appears that the consolidated financials have degraded a bit. **IF** you decided to approve, please do so with restrictions on percentage of net worth, liquid and non-liquid, no reinvestment of interest, capping future note principal reinvestment to note proceeds from redemption or even a reduced percentage. Frankly I am upset that an organization bringing in these dollars cannot agree to a partial sinking fund and appointment of an independent overseer as BNY doesn't commit to doing anything... (Emphasis in Original).

Respondent again failed to take any action after receiving such an email to address any of the issues raised by the due diligence analyst regarding MC Notes. Further, Respondent again chose not to inform investors of the material risk issues raised over and over again by the due diligence analyst reviewing MC Notes. Rather, Respondent continued to sell MC Notes while claiming to rely on the same due diligence reports which were screaming warnings and red flags. When Respondent's own representatives began asking to see the due diligence analyst reports, Mr. Cross testified to the Division that the reason for not giving representatives the reports was that:

...if the analyst makes a statement and we put that statement in the hands of the advisor, guess what happens? Somehow that document in its infinite wisdom will find its way into the hands of an investor...So somehow do you figure out a way to get it in a secured server so that nobody can see it, you know, other than advisors? The problem, even if you do that, is when you create that, guess what they can do? Hit the print screen. **Then they can take that document to the investor and that's just a bad thing.** (Emphasis Added).

From 2003 until 2008 Respondent ignored the seriousness and severity of several material risks and issues raised by the due diligence analyst conducting a review of MC Notes. Respondent never informed investors of any of the heightened risks associated with the MC Notes raised by the due diligence analyst. Not only did Respondent withhold the due diligence analyst reports, the Medical Capital financial statements, and the Client Disclosure Form, which were all strongly recommended to be shared with investors by the due diligence analyst, Respondent even went on to continuously claim that MC Notes were "Fully Secured" and that investors should include MC Notes in their "Fixed Income Arsenal!". Respondent chose to sell more than a half a billion dollars of unregistered, speculative, and high risk securities, which were draped in a mantle of

safety, without disclosing all pertinent information and without highlighting all material risks regarding the securities to unsophisticated investors who purchased them. Today these same investors are left with almost worthless securities.

### **III. JURISDICTION AND AUTHORITY**

1. The Massachusetts Securities Division is a Division of the Office of the Secretary of the Commonwealth with jurisdiction over matters relating to securities as provided for by the Act. The Act authorizes the Division to regulate: 1) offers and/or sales of securities; 2) those individuals and businesses offering and/or selling securities within the Commonwealth; and 3) those individuals and businesses transacting business as broker-dealers and investment advisers within the Commonwealth.

2. The Division brings this action pursuant to the enforcement authority conferred upon it by Section 407A of the Act and M.G.L. c. 30A, wherein the Division has the authority to conduct an adjudicatory proceeding to enforce the provisions of the Act and all regulations and rules promulgated thereunder.

3. This proceeding is brought in accordance with Sections 101, 204, and 407A of the Act and its Regulations. Specifically, the acts and practices constituting violations of the Act occurred in the Commonwealth of Massachusetts.<sup>1</sup>

4. The Division specifically reserves the right to amend this Complaint and/or bring additional administrative complaints to reflect information developed during the current ongoing investigation.

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<sup>1</sup> Section 414 (c) of the Act states in part “an offer to sell or to buy is made in the Commonwealth, whether or not either party is then present in the commonwealth, when the offer (1) originates from the commonwealth or (2) is directed by the offeror to the commonwealth and received at the place to which it is directed, or at any post office in the commonwealth in the case of a mailed offer.”

#### **IV. RESPONDENT**

5. Securities America, Inc. (“Securities America”) is a registered broker-dealer, registered in Massachusetts, with a Central Registration Depository (“CRD”) number of 10205 and with a principal place of business at 12325 Port Grace Blvd., La Vista, Nebraska 68128.

#### **V. RELEVANT TIME PERIOD**

6. Except as otherwise expressly stated, the conduct described herein occurred during the approximate time period of January 1, 2003 until May 30, 2008 (“Relevant Time Period”).

#### **VI. FACTS & ALLEGATIONS**

##### **A. Background**

##### **i. Respondent**

7. Respondent is a registered broker dealer and subsidiary of Ameriprise Financial, Inc.

8. Respondent from 2003 through 2008 sold promissory notes issued by Medical Capital Holdings Inc. and its various Special Purpose Corporations (“SPCs”) including Carlmont Capital II, Medical Provider Funding Corporation (“MPFC”) I, MPFC II, MPFC III (series 1 and 2), MPFC IV (series 1 and 2) and MPFC V (all Medical Capital Holdings Inc. entities will be referred to collectively as “Medical Capital” and all Medical Capital notes as “MC Notes”).

9. MC Notes are not registered securities but are sold as private placement securities under Regulation D, Rule 506, of the 1933 Securities Act.

10. Over four hundred of Respondent’s agents sold MC Notes.

11. Securities America Advisors, Inc. is an SEC registered investment advisor, noticed filed in Massachusetts with a CRD number of 110518, with the same principal place of business as Respondent, and a wholly owned subsidiary of Ameriprise Financial, Inc.

12. A number of Respondent's agents who sold MC Notes are also registered as investment representatives of Securities America Advisory, Inc.

## **ii. Medical Capital in Receivership**

13. Since July of 2009, Medical Capital has been in receivership due to fraud allegations brought against it by the Securities and Exchange Commission ("SEC") and the default of its notes which began on or around August 2008.<sup>2</sup>

14. On August 3, 2009 the SEC obtained an emergency court order against Medical Capital.

15. The Medical Capital receivership (referred to herein as "MC Receivership") has generated a number of reports on the financial status of Medical Capital.

16. Medical Capital through its various SPCs and entities issued the MC Notes through a number of broker dealers which sold them.

17. From 2003 until 2009 Medical Capital has raised over 1.7 billion dollars from investors and collected approximately 323 million dollars in administrative fees.

### *Issues Raised by MC Receivership*

18. The MC Receivership has uncovered a number of issues surrounding Medical Capital's business.

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<sup>2</sup> Up to date information on Medical Capital receivership status can be obtained online at <http://www.medicalcapitalreceivership.com> (last accessed January 24, 2010).



19. The MC Receivership issued a report on August 14<sup>th</sup> of 2009 which describes Medical Capital's financial documents as unreliable and containing a number of serious issues. (A copy of the August 14<sup>th</sup>, 2009 MC Receivership report is placed hereto as Exhibit A).

20. Medical Capital was never subject to audited financials when it issued its 1.7 billion dollars in securities.

21. The MC Receivership has conducted a forensic accounting of the sources and uses of Medical Capital's funds. On January 11, 2010 the MC Receivership issued the following preliminary conclusions regarding Medical Capital:

- Investors are owed principal of \$1.079 billion.
- Medical Capital's lending activities were unprofitable and resulted in losses in excess of \$316 million since the creation of MPFC 1 [a Medical Capital SPC], which is the only MPFC that generated a profit from lending and investing activity.
- No MPFC ever generated enough profit to pay its investors principal and interest.
- Medical Capital requested and was paid administrative fees in excess of \$323 million.
- Medical Capital transferred loans and other assets valued at just under \$1 billion between the eight money raising MPFCs, which facilitated the payment of earlier investors' principal from new investors' funds.

(A copy of page 6 of the January 11, 2010 MC Receivership report is placed hereto as Exhibit B)

22. The MC Receivership has indicated in his reports that Medical Capital overvalued its assets causing the investors which still hold its defaulted notes to hold securities that are valued less than principal.

23. In addition, Medical Capital extracted administrative fees which were based on the erroneous valuation of the underlying assets, resulting in fees consisting of approximately one third of investors principal invested.

24. Medical Capital has also sold assets from one SPC to another so as to charge itself additional fees. The MC Receivership found that the assets sold from one SPC to another were deemed by Medical Capital to have increased in value, when in reality the assets were decreasing in value.

25. Finally, the MC Receivership noted that many of the entities that Medical Capital purchased receivable assets from were in a foreclosed status, even though Medical Capital continued to value those assets at par value.

**B. Sales of MC Notes by Respondent**

26. During the Relevant Time Period Respondent sold approximately 697 million dollars in MC Notes which consists of approximately 37% of the total amount of funds raised by Medical Capital.

27. From 2003 until 2008 Respondent sold MC Notes to 66 Massachusetts investors who purchased about 7.2 million dollars of said notes.

28. To date, 1.079 billion dollars of MC Notes are in default status.

29. Respondent has sold 358 million dollars of the 1.079 billion dollars in MC Notes currently in default.

### **i. Revenue and Incentives**

30. Respondent's representatives collected commissions from the sale of MC Notes up to 6% of the total dollar amount of MC Notes sold.

31. Respondent has collected approximately \$26.6 million in revenue from the sale of MC Notes.

32. In addition, Respondent's executives who sat on the Due Diligence Committee were invited to several seminars at beach and golf resorts which were paid by Medical Capital.

33. For example, in March of 2003 Jay Idt (Respondent's Director of Mutual Funds and member of the Due Diligence Committee) and Mr. Cross attended a Medical Capital sponsored event in Las Vegas at the Ritz Carlton. A choice of Golf or Spa was offered at this event for the attendees and their guests.

34. Mr. Cross testified to the Division that Medical Capital paid for the airfare, hotel and meals at this event.

35. In another example, in October 2007 Mr. Cross attended another Medical Capital event in Pebble Beach, California. Mr. Cross testified that Medical Capital paid for the airfare, hotel, and golf at this event.

### **ii. Marketing of MC Notes**

36. Respondent used seven private placement memorandums ("PPM") from 2003 until 2008 in the sale of MC Notes.

37. Each Medical Capital PPM described Medical Capital as an entity which purchased, held, and collected medical receivables and other financial assets. (As an example, a copy of Medical Provider Funding Corporation V PPM is placed hereto as Exhibit C)

## 1. Fully Secured notes

38. The MC Notes were described in the Medical Capital PPMs to be secured notes which offered minimum monthly, quarterly or annual interest payments.

39. In addition to the Medical Capital PPM, Respondent also used various marketing materials to solicit interest from investors in MC Notes.

40. Kevin Miller (Respondent's Chief Compliance Officer) testified to the Division that a reviewer from Respondent's compliance department would review each marketing material regarding Medical Capital before it was sent to investors.

41. In July 2005, a representative of Respondent submitted a Medical Capital marketing document ("2005 Medical Capital Marketing") to Respondent's compliance department for approval. Respondent approved for a period of three years the 2005 Medical Capital Marketing document without any required changes. (A copy of the 2005 Medical Capital Marketing document is placed hereto as Exhibit D)

42. In the 2005 Medical Capital Marketing document the MC Notes are held out to be "Secured Notes" since they are "offered exclusively through NASD Registered Broker Dealers, Available to Accredited Investors Only, and Non-redeemable During Term". (See Exhibit D page 15)

43. Furthermore, the 2005 Medical Capital Marketing document used by Respondent informs investors that some of the key points of MC Notes are that: "Notes Pay High Yield, Interest Paid Monthly Quarterly or Annually, Principal Paid in Full at Maturity, **Notes are Fully Secured...Highly Diversified Provider Portfolio...**". The MC Notes were even held out to be a "**Fixed Income Arsenal!**" (Emphasis added) (See Exhibit D page 18)

44. Lawrence Panzeri, a Securities America registered representative testified that he informed investors that the notes were “secured” because Medical Capital was “purchasing these receivables from the medical industry. That was to be paid back by Medicare, Medicaid, insurance companies, casualty companies. I would disclose to them that I would feel comfortable with that.”

45. A number of Massachusetts investors who purchased MC Notes were unsophisticated investors that did not have experience in investing in high risk products.

46. Many Massachusetts investors informed the Division that they did not completely understand how the MC Notes were structured at the time of purchase.

47. When asked to explain the MC Notes, many Massachusetts investors informed the Division that they simply relied on their registered representatives’ recommendations and the due diligence that Respondent had conducted on Medical Capital.

48. Many of Mr. Panzeri’s Massachusetts investors informed the Division that they understood the MC Notes to be a safe investment that had a low risk of losing its principal and interest.

49. Some Massachusetts investors perceived the fact that the notes were held out to be “secured” as indicia that the notes held a low risk of loss.

50. For example, Investor I who purchased MC Notes through Mr. Panzeri informed the Division that she thought the investments were secured and safe because she was told that they were backed by medical companies.

51. In another example, Investor II who also purchased MC Notes through Mr. Panzeri placed her entire retirement savings in MC Notes because the materials

distributed to her held the notes to be a source of fixed income. Investor II also thought the notes were secure and safe.

52. MC Notes were to some degree collateralized by the receivables purchased and did pay periodic interest payments to investors.

53. However, labeling the MC Notes as “Fully Secured” and a “Fixed Income Arsenal!” to unsophisticated investors without disclosing all material risks associated was misleading.

### **iii. Marketing of MC Notes**

54. Mr. Panzeri (one of Respondent’s registered representative) testified to the Division that about once a year he organized dinner seminars to provide information to investors on MC Notes.

55. In 2003 for example, Mr. Panzeri held such a seminar where about 80-100 individuals attended to hear about MC Notes.

56. Mr. Panzeri testified that Respondent would cover the costs of the event.

57. Mr. Panzeri testified to the Division that he informed Respondent’s compliance group of this event.

58. Not all of the individuals who attended Mr. Panzeri’s event in 2003 were clients of his.

59. When asked if “there were people in that room that you hadn’t met before?” Mr. Panzeri responded “Absolutely, right.”

60. Copies of Medical Capital’s PPM were on the table for investors to pick up and take home with them during the seminar held by Mr. Panzeri in 2003.

61. When asked if there was anything that investors needed to sign before picking up a Medical Capital PPM, Mr. Panzeri responded “They were just able to pick it up”.

62. Mr. Panzeri testified that he held at least one dinner seminar event per year.

63. Mr. Panzeri testified that investors were not asked if they were accredited and sophisticated before they were allowed to attend Mr. Panzeri’s 2003 seminar event on Medical Capital.

64. Mr. Panzeri testified that investors were not asked if they were accredited and sophisticated before they were given Medical Capital PPMs during Mr. Panzeri’s 2003 seminar event on Medical Capital.

**C. Due Diligence Reports Ignored & Material Information Withheld from Investors**

**i. Promise Made by Respondent to Investors**

65. Respondent provided Medical Capital investors with a PPM and a Subscription Agreement.

66. On the last page of the Subscription Agreement for each Medical Capital note offering was a Placement Agent Certification. (A copy of the Placement Agent Certification is placed hereto as Exhibit E)

67. The Placement Agent Certification was signed by a representative of Respondent.

68. The Placement Agent Certification states in part:

**BASED ON THE INFORMATION OBTAINED FROM THE SUBSCRIBER CONCERNING HIS INVESTMENT OBJECTIVES, HIS OTHER INVESTMENTS AND HIS FINANCIAL SITUATION AND NEEDS, THE UNDERSIGNED PLACEMENT AGENT HAS REASONABLE GROUNDS TO BELIEVE THAT AN INVESTMENT IN THE NOTES OF THE COMPANY IS SUITABLE FOR THE SUBSCRIBER. PRIOR TO THE SUBSCRIBER’S EXECUTING THIS**

SUBSCRIPTION AGREEMENT, **THE UNDERSIGNED PLACEMENT AGENT HAS INFORMED THE SUBSCRIBER OF ANY COMPENSATION THE UNDERSIGNED PLACEMENT AGENT SHALL RECEIVE ON ACCOUNT OF THE SALE OF THE NOTES HEREIN AND ALL PERTINENT FACTS RELATING TO AN INVESTMENT IN THE NOTES, INCLUDING THE RISK FACTORS DISCLOSED IN THE MEMORANDUM. THE UNDERSIGNED BELIEVES THAT THE REPRESENTATIONS AND WARRANTIES ABOVE ARE TRUE AND CORRECT.**  
(Emphasis in bold added)

(See Exhibit E)

69. Unlike what investors were promised, Respondent did not inform investors of “all pertinent facts relating to an investment in the notes”. (See Exhibit E)

**ii. Omissions by Respondent**

*Background on Due Diligence Analyst Reports*

70. Respondent has a review process for approving new securities on its platform consisting of a standing Due Diligence Committee which evaluates new offerings to determine if they should be made available for sale by Respondent’s registered representatives.

71. During the Relevant Time Period, Thomas Cross was Respondent’s Senior Vice President, Chairman of the Due Diligence Committee, Head of Sales, and in charge of the relationship between Respondent and Medical Capital.

72. Respondent’s Due Diligence Committee was responsible for reviewing and approving products on Respondent’s platform, such as MC Notes.

73. From 2003 until 2009 the following individuals were voting members of the Due Diligence Committee for Respondent: Thomas Cross (Senior Vice President and Head of Distribution Group), Jim Nagengast (President and Chief Financial Officer), Dennis King



(Senior Vice President, Business Development/Fee Based Sales), Jay Idt (First Vice President, Product Distribution), Kevin Miller (Chief Compliance Officer and Deputy General Counsel), James Heeney (Vice President, Sales Supervision & Operations), Dough Fehr (Director, Investment Research), Scott Hoht (Senior Vice President and General Counsel), David Spinar (Senior Vice President and Chief Compliance Officer).

74. Respondent in conducting due diligence for MC Notes relied on three sources of information: third party analyst due diligence reports, information contained within the Medical Capital Private Placement Memorandums (“PPM”) , and information obtained by attending Medical Capital conferences.

75. Part of the due diligence process included the utilization of third party due diligence analysts which generated various reports on MC Notes and their related entities.

76. A third party due diligence analyst generates an analyst report, which is an in depth analysis into the offering.

77. Respondent utilized the same third party due diligence analyst (referred to herein as “D.D. Analyst”) to generate the analyst reports on MC Notes.

78. Mr. Cross testified to the Division that Respondent relied mostly on the D.D. Analyst reports in its approval of MC Notes on Respondent’s platform.

79. From 2003 until 2008 Respondent obtained five D.D. Analyst reports on MC Notes.

80. Respondent from 2003 through 2008 sold promissory notes issued by six Medical Capital SPCs : Carlmont Capital II, Medical Provider Financial Corporation (“MPFC”) I, MPFC II, MPFC III (series 1 and 2), MPFC IV (series 1 and 2) and MPFC V.

81. Respondent obtained D.D. Analyst reports on Carlmont Capital II, MPFC I, MPFC III, MPFC IV, and MPFC V.
82. Respondent sometimes began selling MC Notes before a D.D. Analyst report was generated on the offering.
83. For example, Respondent sold MC Notes for MPFC I beginning on January 20, 2004 yet the D.D. Analyst report for the offering is dated July 8, 2008.
84. In another example, Respondent sold MC Notes for MPFC III beginning on July 5, 2005 yet the D.D. Analyst report is dated August 5, 2005.
85. Mr. Cross testified that Respondent heavily relied on the D.D. Analyst reports in approving the MC Notes.

### **iii. Medical Capital Paid for D.D. Analyst Reports**

86. From 2003 until 2008 Medical Capital paid for the due diligence analyst reports which Respondent claims to have relied upon in conducting their due diligence of MC Notes.
87. Mr. Cross testified to the Division that he did not find the fact that Medical Capital paid for the D.D. Analyst reports to have created a conflict of interest whereby the due diligence analyst firm would be working for the issuer and not the broker-dealer relying on the review.
88. In an e-mail dated May 29<sup>th</sup>, 2003, Allen Boelter (Representative of Respondent and non-voting member of the Due Diligence Committee) wrote to members of the Due Diligence Committee and stated "The general practice is to have the B/D make the payment to the DD Firm so it can not be seen as the DD Firm working for the

organization that is being reviewed.” (The discussed email is attached hereto as Exhibit F).

89. From 2003 until 2008, Medical Capital paid the D.D. Analyst reports directly for the review conducted.

#### **iv. Carlmont Capital II Offering**

90. On June 2<sup>nd</sup>, 2003 Respondent received a D.D. Analyst report on Medical Capital’s Carlmont Capital Special Purpose Corporation II notes (“MC Carlmont”). (The Conclusions and Recommendations section of the MC Carlmont D.D. Analyst report is placed hereto as Exhibit G).

91. The D.D. Analyst recommended that Respondent require that Medical Capital amend its MC Carlmont PPM to “attach all year-end income statements and balance sheets for the Company as Exhibits to the PPM.” (See Exhibit G)

92. The D.D. Analyst also recommended that Respondent require that Medical Capital “provide a description of all material litigation effecting” it. (See Exhibit G)

93. Medical Capital’s year-end income statements and balance sheets were never provided to investors by Respondent.

94. Additionally, all material litigation effecting Medical Capital was also not included in the PPM for MC Carlmont.

95. Further, Mr. Corss testified that not only were all year-end income statements and material litigation information not included in the MC Carlmont PPM, but that Respondent never made a request to Medical Capital that such information be included.

96. The D.D. Analyst also recommended in his 2003 report that Respondent should :

...obtain a written commitment of MCH and the Company to provide you, your registered representatives and

investors, with the monthly distribution checks or other regular communication, copies of the monthly administrator's reports so that you can track the collateral coverage ratios.

(See Exhibit G)

97. Collateral Coverage Ratios ("CCR") measure the value of assets purchased by Medical Capital over the value of notes issued. If the value of the assets purchased exceeds the value of notes issued then Medical Capital would extract the difference as a fee.

98. Mr. Cross testified that Respondent did not request that information on the CCR be provided to investors.

99. Medical Capital distributed CCR reports to Respondent on Medical Capital offerings.

100. Respondent did not disclose CCR reports to investors who purchased MC Carlmont notes.

101. Respondent failed to reasonably act upon receiving the D.D. Analyst report for MC Carlmont offering.

#### **v. MPFC I**

102. On June 8<sup>th</sup>, 2004 Respondent received a D.D. Analyst report on MPFC I note offering. (The Conclusions and Recommendations section of the D.D. Analyst report of MPFC I is placed hereto as Exhibit H).

103. Respondent began selling MPFC I notes on January 1, 2004 before receiving the D.D. Analyst report for MPFC I.

104. Similar to the report generated in 2003, the due diligence analyst also recommended again that Respondent require Medical Capital to provide representatives and investors with information on the CCR.

105. Respondent did not request that Medical Capital provide investors with information on the CCR in 2004.

#### vi. MPFC II

106. Respondent began selling MPFC II notes on March 4, 2004.

107. The Division has not received a D.D. Analyst report for MPFC II notes.

108. On January 21<sup>st</sup>, 2005 Respondent received a due diligence screening report on MPFC II. (The MPFC II screening report is placed hereto as Exhibit I.)

109. A due diligence screening report is less in depth than an analyst report.

110. The MPFC II screening report raised a number of issues:

While we feel that the offerings warrant further review, we **have serious concerns:**

- The **most critical** is the fact that the Company may use some of the offering proceeds to pay interest, repay principal, and/or pay commissions.
- The **lack of a sinking fund** to make principal payments on the Notes increases the risk that there won't be sufficient cash to make the principal payments when they mature. If the collateral securing the Notes is insufficient and there is a default, any current or additional senior debt would have priority.
- The notes are redeemable by the Company at any time.
- Holdings **does not have audited financial statements** and has limited financial history and no prior performance information was provided. This information will be critical if a full research report is to be done.

(Emphasis Added)  
(See Exhibit I)

111. Respondent did not take any reasonable action on any of the four issues raised above in the MPFC II screening report.

112. The MPFC II PPM contained a section titled “Risk Factors”.

113. Respondent did not inform investors of MPFC II that the “use of offering proceeds to pay interest, repay principal, and/or pay commissions” constitutes a “critical” concern. Such information was not contained within the “Risk Factors” section of the MPFC II PPM. (See Exhibit I)

114. Respondent did not inform investors of MPFC II that the fact that the “notes are redeemable by the Company at any time” is a serious concern. Such information was not contained within the “Risk Factors” section of the MPFC II PPM.

115. Respondent did not inform investors that the lack of audited financial statements for Medical Capital was deemed to be a critical concern by a due diligence analyst. Such information was not contained within the “Risk Factors” section of the MPFC II PPM.

116. On July 26<sup>th</sup>, 2004 David Spinar (Respondent’s President and Chief Compliance Officer) wrote an email to Mr. Cross and ccd to all members of the Due Diligence Committee which stated in part:

Our NASD district received word from another NASD district that we are among the larger distributors of Med. Cap. Furthermore, the other **NASD district expressed concern that Med Cap didn’t have audited financials**, and that instead there had only been a “review” of the statements. (Emphasis in Bold added).

(See Exhibit J)

117. On July 29<sup>th</sup>, 2004 Mr. Spinar sent Jim Nagengast (Respondent’s Executive Vice President & Chief Financial Officer) an email ccd to Mr. Cross and Mr. Idt which

contains within it a draft letter to be sent to Medical Capital requesting that audited financials be completed. (A copy of said email is placed hereto as Exhibit K)

118. On February 15<sup>th</sup>, 2005 Jim Nagengast wrote Mr. Cross an email concerning Medical Capital's lack of audited financials:

My big concern is the audited financials. At this point, there is no excuse for not having audited financials...it is a cost they simply have to bare to offer product through our channel.

We simply have to tell them that if they don't have financials by XXXX date we will stop distributing the product on that date. Then they can decide if its worth spending \$50,000 to have it done. If they won't spend the money, **that should give us concerns.** (Emphasis Added).

See Exhibit K

119. Medical Capital never obtained audited financials for any of the Medical Capital entities.

120. Mr. Cross testified that the reason Medical Capital never obtained audited financials was the cost of such a review.

121. Medical Capital earned more then 323 million dollars in fees from its issuance of MC Notes.

#### **vii. MPFC III**

122. On August 8<sup>th</sup>, 2005 Respondent received a D.D. Analyst report on MPFC III note offering. ( A copy of the Conclusions and Recommendation section of the D.D. Analyst report for MPFC III is placed hereto as Exhibit L)

123. Respondent began selling MPFC III notes on July 5, 2005 before receiving D.D. Analyst report for MPFC III.

124. Similar to the D.D. Analyst report for MPFC I generated in 2004, the D.D. Analyst report for MPFC III also recommended that Respondent require Medical Capital to provide representatives and investors with information on the CCR.

125. Respondent did not request that Medical Capital provide investors with information on the CCR in 2005.

126. Additionally, the MPFC III Report recommended a number of new issues that were not addressed in the D.D. Analyst report of MPFC I.

127. The D.D. Analyst report for MPFC III included the following recommendations:

Furthermore, you should **strongly consider that prospective investors review and acknowledge receipt of this report to understand the material risks associated with MPFC III** as compared to prior MCC offerings, including:

1. The Note Agreement **does not require a sinking fund** for payment of the notes or require the maintenance of any particular financial ratios to better ensure future repayment of the Notes;
2. The ability to invest up to \$50,000,000 in equity securities of all types of business and make mortgage loans to receivables sellers or other parties in health care industry, outside of MCC core expertise, and **inadequate PPM disclosures regarding mortgage financing, conflicts of interest as dual lender and commercial real estate risks;**
3. No independent directors, especially given the myriad of related and conflicted transactions and contractual relationships by and among the Company, MCC, MCH and MediTrack;
4. The executives of MCC, MR. Field and Mr. Lampariello, **have not agreed to personally certify monthly net collateral coverage and with individual indemnity directly to Noteholders;**



5. A diluted Note Agreement with Wells, including lack of disbursing agent function, a higher 50% threshold for Noteholders to enforce remedies, and the general lack of responsibility and oversight that was incorporated in prior offering;
6. Given the burgeoning size and presence of MCC and the special purpose entities and the dollars involved, **use of a local CPA firm rather than one of the nationals**; and
7. The ability of MPFC III to purchase receivables that are greater than 180 days, **which is inconsistent with MCC's prior strategic approach** of buying quality insurance company and government receivables, which "turn" every 90 days.

(Emphasis Added)  
(See Exhibit L)

128. Mr. Cross testified that the D.D. Analyst report for MPFC III was never given to investors nor was there a request to Medical Capital to ever share the D.D. Analyst report of MPFC III with investors.

129. Mr. Cross testified that he considered the D.D. Analyst who generated all reports on Medical Capital to be a reputable individual within the due diligence industry.

130. Yet Mr. Cross further testified that Respondent did not consider any of the seven issues listed in the D.D. Analyst report of MPFC III to be concerns that needed to be addressed at all.

131. The MPFC III PPM contained within it a section titled "Risk Factors".

132. Issues two through seven in the D.D. Analyst report of MPFC III were not contained within the MPFC III PPM Risk Factors section.

133. Respondent did not inform investors of MPFC III that issues two through seven in the D.D. Analyst report of MPFC III were raised as material risks.

### viii. MPFC IV

134. On December 1<sup>st</sup>, 2006 Respondent received a D.D. Analyst report on the MPFC IV note offering. (A copy of the Conclusions and Recommendations section of the D.D. Analyst report on MPFC IV is placed hereto as Exhibit M)

135. Similar to the D.D. Analyst report for MPFC III generated in 2005, the D.D. Analyst report for MPFC IV also recommended that Respondent require Medical Capital to provide representatives and investors with information on the CCR.

136. Respondent did not request that Medical Capital provide investors with information on the CCR in 2006.

137. The D.D. Analyst report for MCFC IV also contained the same recommendations as the D.D. Analyst report for MPFC III.

138. The D.D. Analyst report for MPFC IV included the following recommendations:

Furthermore, you should **strongly consider** that **prospective investors review and acknowledge receipt of this report to understand the material risks associated with MPFC IV** as compared to prior MCC offerings, including:

8. The Note Agreement **does not require a sinking fund** for payment of the notes or require the maintenance of any particular financial ratios to better ensure future repayment of the Notes;
9. The ability to invest up to \$50,000,000 in equity securities of all types of business and make mortgage loans to receivables sellers or other parties in health care industry, outside of MCC core expertise, and **inadequate PPM disclosures regarding** mortgage financing, conflicts of interest as dual lender and commercial real estate risks;
10. No independent directors, especially given the myriad of related and conflicted transactions and contractual

relationships by and among the Company, MCC, MCH and MediTrack;

11. The executives of MCC, MR. Field and Mr. Lampariello, **have not agreed to personally certify** monthly net collateral coverage and with individual indemnity directly to Noteholders;
12. A diluted Note Agreement with BNY, including lack of disbursing agent function, a higher 50% threshold for Noteholders to enforce remedies, and the general lack of responsibility and oversight that was incorporated in prior offering;
13. Given the burgeoning size and presence of MCC and the special purpose entities and the dollars involved, **use of a local CPA firm rather than one of the nationals;** and
14. The ability of MPFC III to purchase receivables that are greater than 180 days, **which is inconsistent with MCC's prior strategic approach** of buying quality insurance company and government receivables, which "turn" every 90 days.

(Emphasis Added)  
(See Exhibit M)

139. Mr. Cross testified that the D.D. Analyst report for MPFC IV was never given to investors nor was there a request to Medical Capital to ever share the D.D. Analyst report with investors.

140. Mr. Cross further testified that Respondent did not consider any of the seven issues listed in the D.D. Analyst report for MPFC IV to be concerns that needed to be addressed at all.

141. The MPFC IV PPM contained within it a section titled "Risk Factors".

142. Issues two through seven in the D.D. Analyst report on MPFC IV were not contained within the MPFC IV PPM Risk Factors section.

143. Respondent did not inform investors of MPFC IV that issues two through seven in the D.D. Analyst report on MPFC IV were raised as material risks.

144. Additionally, in 2006 the D.D. Analyst created a Client Disclosure Form which contains in it six of the seven issues raised in the D.D. Analyst report of MPFC IV.

145. The D.D. Analyst recommended to Respondent that the Client Disclosure Form be distributed to investors. (A copy of the Client Disclosure Form is placed hereto as Exhibit N)

146. Medical Capital received the Client Disclosure Form and edited the document by adding comments to each issue raised within the Client Disclosure Form.

147. The D.D. Analyst sent Respondent the Client Disclosure Form with Medical Capital's responses in an email to Jay Idt dated November 15, 2006. This email was forwarded to Mr. Cross on the same day. (A copy of the November 15, 2006 email with Medical Capital's responses to the Client Disclosure Form is placed hereto as Exhibit O)

148. Mr. Cross testified that Respondent's Due Diligence Committee considered Medical Capital's answers to the Client Disclosure Form to be reasonable.

149. The D.D. Analyst deemed Medical Capital's responses to be "BS" and informed Respondent of its opinion. (See Exhibit O)

150. The Client Disclosure Form was never given by Respondent to any investors of MC Notes.

151. In an email from the D.D. Analyst, forwarded to the Jay Idt (Respondent's Due Diligence Committee member) on November 15, 2006, the D.D. Analyst expresses his frustration with Medical Capital's responses to the Client Disclosure Form:

Fred, I disagree with every point and nothing in MPFC IV has changed structurally. **It is very unfortunate that you**

**have the ability to enhance this offering but see fit to peel off the cash every month.** For \$250 million if BNY wants to do nothing in its capacity that doesn't prevent you from appointing an independent audit person or firm to actually accomplish oversight for investors. Nothing similarly prohibits you from leaving some of the cash in a sinking fund to provide extra measure of security. Joey told me last time either he or Sid would personally certify the CCR at 1:1 or better every month; I even drafted a certification to use which never was implemented. I could go on and on but **if you guys figure "the money keeps rolling in, why not do anything?"**, then that's certainly your business decision. (Emphasis Added)

(A copy of the November 15, 2006 email is placed hereto as Exhibit P)

152. Mr. Cross testified that Respondent took no further action after receiving this email.

153. In another email on November 30, 2006 the D.D. Analyst directed his frustrations regarding Medical Capital to Respondent:

...As I stated to both of you, none of the recommended changes from MPFC III were implemented, including simple definitional problems in the Administrative Service Agreement. It also appears that the consolidated financials have degraded a bit. **IF** you decided to approve, please do so with restrictions on percentage of net worth, liquid and non-liquid, no reinvestment of interest, capping future note principal reinvestment to note proceeds from redemption or even a reduced percentage. Frankly I am upset that an organization bring in these dollars cannot agree to a partial sinking fund and appointment of an independent overseer as BNY doesn't commit to doing anything... (Emphasis in Original).

(A copy of the November 30, 2006 email is placed hereto as Exhibit Q)

154. Respondent took no further action after receiving such an email and continued selling MC Notes.

155. In fact, Respondent approved the sale of MPFC IV notes the same day it received the D.D. Analyst report.

156. The D.D. Analyst report of MPFC IV was sent to the Due Diligence Committee on December 1, 2006 for review in an email from Brian Crockett (Respondent's Product Database Administrator) which read:

Please review the attached Med Cap offering report as we will discuss in today's DD meeting. We have a list of about 250 reps waiting on approval of this product. Legal has already reviewed and approved the selling agreement **so if we can get the DD Committee to approve the offering based on this report, we can get the agreement signed and out the door today.** (Emphasis Added).

(A copy of the December 1, 2006 email is placed hereto as Exhibit R)

157. Respondent's Due Diligence Committee met on the same day and dismissed all of the material risks raised by the D.D. Analyst.

158. The Due Diligence Committee approved the sale of MPFC IV notes in 2006 without taking any action on any of the several issues raised in the Client Disclosure Form.

159. Investors were not notified that the D.D. Analyst had been raising a number of issues as "material risks" and that a Client Disclosure Form had been created to inform investors of such risks.

160. Respondent received over \$7.2 million dollars in revenue from the sale of MPFC IV notes.

#### **ix. MPFC V**

161. In an email dated October 17, 2006, the D.D. Analyst informed Respondent's Due Diligence Committee that the MPFC V report will not be favorable.

162. On November 27<sup>th</sup>, 2007 Respondent received a D.D. Analyst report on MPFC V. (A copy of the Conclusions and Recommendations section of the D.D. Analyst report for MPFC V is placed hereto as Exhibit S)

163. Similar to the D.D. Analyst report for MPFC IV generated in 2006, the D.D. Analyst report for MPFC V also recommended that Respondent require Medical Capital to provide representatives and investors with information on the CCR.

164. Respondent did not request that Medical Capital provide investors with information on the CCR in 2007.

165. The D.D. Analyst report for MCFC V also contained the same recommendations as the D.D. Analyst report for MPFC IV.

166. The D.D. Analyst report for MPFC V included the following recommendations:

Furthermore, you should **strongly consider** that **prospective investors review and acknowledge receipt of this report to understand the material risks associated with MPFC V** as compared to prior MCC offerings, including:

15. The Note Agreement **does not require a sinking fund** for payment of the notes or require the maintenance of any particular financial ratios to better ensure future repayment of the Notes;
16. The ability to invest up to \$50,000,000 in equity securities of all types of business and make mortgage loans to receivables sellers or other parties in health care industry, outside of MCC core expertise, and **inadequate PPM disclosures regarding** mortgage financing, conflicts of interest as dual lender and commercial real estate risks;
17. No independent directors, especially given the myriad of related and conflicted transactions and contractual relationships by and among the Company, MCC, MCH and MediTrack;

18. The executives of MCC, MR. Field and Mr. Lampariello, **have not agreed to personally certify** monthly net collateral coverage and with individual indemnity directly to Noteholders;
19. A diluted Note Agreement with BNY, including lack of disbursing agent function, a higher 50% threshold for Noteholders to enforce remedies, and the general lack of responsibility and oversight that was incorporated in prior offering;
20. Given the burgeoning size and presence of MCC and the special purpose entities and the dollars involved, **use of a local CPA firm rather than one of the nationals;** and
21. The ability of MPFC III to purchase receivables that are greater than 180 days, **which is inconsistent with MCC's prior strategic approach** of buying quality insurance company and government receivables, which "turn" every 90 days.

(Emphasis Added)  
(See Exhibit S)

167. Mr. Cross testified that the D.D. Analyst report for MPFC V was never given to investors nor was there ever a request to Medical Capital to share the MPFC V report with investors.

168. Mr. Cross further testified that Respondent did not consider any of the seven issues listed in the D.D. Analyst report for MPFC V to be concerns that needed to be addressed at all.

169. The MPFC V PPM contained within it a section titled "Risk Factors".

170. Issues two through seven in the D.D. Analyst report on MPFC V were not contained within the MPFC V PPM Risk Factors section.

171. Respondent did not inform investors of MPFC V that issues two through seven in the D.D. Analyst report on MPFC V were raised as material risks.



172. The D.D. Analyst for the MPFC V report also sent Respondent's Due Diligence Committee the same Client Disclosure Form which was given to Respondent in 2006.
173. The Client Disclosure Form was recommended to be distributed to investors and registered representatives before an investment into MPFC V notes was made.
174. The Client Disclosure Form was never given to investors by the Respondent.
175. Investors were not notified that a due diligence analyst had been raising a number of issues as "material risks" and that a Client Disclosure Form had been created to inform investors of such risks.
176. Respondent received over \$6.9 million dollars in revenue from the sale of MPFC V notes.
177. Respondent did not give investors any of the D.D. Analyst reports on Medical Capital, nor did Respondent share their contents with investors, even as the D.D. Analyst himself began requesting that the reports be shared with investors prior to investing.
178. Additionally, not only did Respondent refuse to share the D.D. Analyst reports with investors, but it also refused to share the reports with its own representatives who sold the notes.
179. When asked why Respondent did not share the D.D. Analyst reports with its own representatives, Mr. Cross testified to the Division that the reason for not giving advisors the reports was that :

...if the analyst makes a statement and we put that statement in the hands of the advisor, guess what happens? Somehow that document in its infinite wisdom will find its way into the hands of an investor...So somehow do you figure out a way to get it in a secured server so that nobody can see it, you know, other than advisors? The problem, even if you do that, is when you create that, guess what they can do? Hit the print screen. **Then they can take that**

**document to the investor and that's just a bad thing.**  
(Emphasis Added).

**x. Financial Statements**

180. Respondent obtained Medical Capital financial statements from 2003 until 2008.

181. When asked if financial statements of Medical Capital entities should be included in the Medical Capital PPMs given to investors, Mr. Cross testified that:

A. I guess if I were an investor, I would like to see, you know, financial information around, you know, the particular company, you know, the actual holding company. But each special purpose corp. was a separate entity so the financial condition of the prior offerings would be, you know, as important to me as the financial condition of, you know, the parent company as well.

182. On the topic of including Medical Capital's financial statements in the PPM, Mr.

Cross testified that financial statements are a material piece of information:

Q. Would you consider this information to be material for investors to have with them?

A. I think that this would be the kind of information that an investor would like to have knowledge of, yes.

183. The D.D. Analyst recommended that financial statements be provided to Medical Capital investors.

184. Respondent never provided Medical Capital's financial statements to investors who purchased MC Notes from 2003 until 2008.

**VII. VIOLATIONS OF SECURITIES LAWS**

**A. COUNT I – VIOLATIONS OF §101 BY RESPONDENT**

185. Section 101 of the Act provides in pertinent part:

It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly:

(1) to employ any device, scheme or artifice to defraud,

(2) 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 light of the circumstances under which they are made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

186. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1-184.

187. The conduct of Respondent as described above, constitutes violations of M.G.L. c. 110A, § 101.

**B. COUNT II – VIOLATIONS OF § 204 (a) (2) (B) BY RESPONDENT**

188. Section 204 (a)(2)(B) of the Act provides in pertinent part:

(a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:–

(B) has willfully violated or willfully failed to comply with any provision of this chapter . . . .

189. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1-184.

190. The conduct of Respondent as described above constitute violations of M.G.L. c. 110A, § 204 (a)(2)(B).

C. COUNT III – VIOLATIONS OF § 204 (a)(2)(G) BY RESPONDENT

191. Section 204 (a)(2)(G) of the Act provides in pertinent part:

(a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:–

(G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business.

192. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1-184.

193. The conduct of Respondent as described above constitute violations of M.G.L. c. 110A, § 204 (a)(2)(G).

194. Without limiting the generality of the foregoing, the conduct of Respondent as set forth above constitutes violations of the following provisions of the Regulations:

950 CMR Section 12.204 (1)(a):

...(15) Effecting any transaction in, or inducing the purchase or sale of, any security by means of any manipulative, deceptive or fraudulent device, practice, plan, program, design or contrivance...

(18) Making any advertising or sales presentation, either in written or oral form, in such a fashion as to be deceptive or misleading...

(28) Failing to comply with any applicable provision of the NASD rules of Fair Practice or any applicable fair practice or ethical standard promulgated by the SEC or by a self-regulatory organization approved by the SEC.

195. Without limiting the generality of the foregoing, applicable NASD rules include the following:

**IM-2310-2. Fair Dealing with Customers**

(a)(1) Implicit in all member and registered representative relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of the Association's Rules, with particular emphasis on the requirement to deal fairly with the public...

**2110. Standards of Commercial Honor and Principles of Trade**

A member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.

**2120. Use of Manipulative, Deceptive or Other Fraudulent Devices**

No member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance.

**2210. Communications with the Public**

(d) Content Standards

(1) Standards Applicable to All Communications with the Public

(A) All member communications with the public shall be based on principles of fair dealing and good faith, must be

fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service. No member may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communications to be misleading.

(B) No member may make any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public. No member may publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading. . . .

#### D. COUNT IV – VIOLATIONS OF § 204 (a)(2)(J) BY RESPONDENT

196. Section 204 (a)(2)(J) of the Act provides in pertinent part:

The secretary may by order deny, suspend, or revoke any registration if he finds (1) that the order is in the public interest and (2) that the applicant or registrant (J) has failed reasonably to supervise agents, investment adviser representatives or other employees to assure compliance with this chapter.

197. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1-184.

198. The conduct of Respondent, as described above, constitutes violations of M.G.L. c. 110A, § 204 (a)(2)(J).

### **VIII. STATUTORY BASIS FOR RELIEF**

#### Violations, Cease and Desist Orders and Costs

199. Section 407A(a) of the Act provides in pertinent part that:

(a) If the secretary determines, after notice and opportunity for a hearing, that any person has engaged in or is about to engage in any act or practice constituting a violation of any provision of this chapter or any rule or order issued thereunder, he may order such person to cease and desist from such unlawful act or practice and may take affirmative action, including the imposition of an

administrative fine, the issuance of an order for accounting, disgorgement or rescission or any other relief as in his judgment may be necessary to carry out the purposes of [the Act].

200. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1 through 184 above.

201. Respondent directly and indirectly engaged in the acts, practices, and courses of business as set forth in this Complaint above, and it is the Division's belief that Respondent will continue to engage in acts and practices similar in subject and purpose, which constitute violations if not ordered to cease and desist.

#### **IX. PUBLIC INTEREST**

For any and all of the reasons set forth above, it is in the public interest and will protect Massachusetts investors, to provide the relief requested in Section X below.

#### **X. RELIEF REQUESTED**

Wherefore, the Enforcement Section of the Division requests that Hearing Officer take the following action:

A. Find that all the sanctions and remedies detailed herein are in the public interest and necessary for the protection of Massachusetts investors;

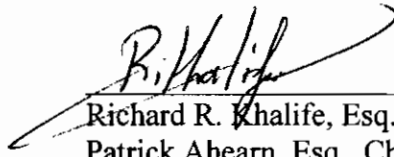
B. Find as fact the allegations set forth in paragraphs 1 through 184 of the Complaint; and

C. Enter an order (a) requiring Respondent to permanently cease and desist from committing any further violations of the Act and Regulations, (b) requiring restitution to all Massachusetts investors whom Respondent sold MC Notes to in an amount that a Hearing Officer deems appropriate, (c) censuring Respondent, (d) requiring Respondent to pay an administrative fine in an amount and upon such terms and

conditions as a Hearing Officer may determine, and (e) taking any other action that a Hearing Officer may deem appropriate in the public interest and necessary for the protection of Massachusetts investors.

**ENFORCEMENT SECTION  
MASSACHUSETTS SECURITIES DIVISION**

By its attorneys,

A handwritten signature in black ink, appearing to read "Richard R. Khalife", is written over a horizontal line. The signature is fluid and cursive.

Richard R. Khalife, Esq.

Patrick Ahearn, Esq., Chief of Enforcement  
Massachusetts Securities Division  
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