UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 2366 /February 27, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16182

In the Matter of		
PAUL EDWARD "ED" LLOYD, JR., CPA	:	ORDER

This Order partially grants and partially denies Respondent Paul Edward "Ed" Lloyd, Jr., CPA's (Lloyd) January 16, 2015, Motion for Summary Disposition, so as to simplify and streamline the proceeding.

The Securities and Exchange Commission (Commission) instituted this proceeding with an Order Instituting Proceedings (OIP) on September 30, 2014, pursuant to Sections 8A of the Securities Act of 1933 (Securities Act), 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act), 203(f) and 203(k) of the Investment Advisers Act of 1940 (Advisers Act), and 9(b) of the Investment Company Act of 1940. Lloyd filed an Answer to the OIP on October 27, 2014. The hearing, expected to last no more than two weeks, is scheduled to commence on March 16, 2015, in Charlotte, North Carolina. *See Paul Edward "Ed" Lloyd, Jr., CPA*, Admin. Proc. Rulings Release No. 2005, 2014 SEC LEXIS 4288 (Nov. 12, 2014).

Lloyd filed his Motion for Summary Disposition, pursuant to 17 C.F.R. § 201.250(a), in accordance with leave granted. *See Paul Edward "Ed" Lloyd, Jr., CPA*, Admin. Proc. Rulings Release No. 2217, 2015 SEC LEXIS 147 (Jan. 14, 2015). The Division of Enforcement (Division) timely filed an opposition,[1] and Lloyd, a reply. This Order is based on those pleadings and Lloyd's Answer.

Lloyd is a North Carolina-licensed CPA and tax planner and preparer; during the relevant period he was also a registered representative and associated person of LPL Financial, LLC (LPL), a Commission-registered broker-dealer and investment adviser. Answer at 3 (admitting OIP ¶ 9). The OIP alleges that he violated Securities Act Section 17(a); Exchange Act Sections 10(b) and 15(a) and Rule 10b-5; and Advisers Act Sections 206(1), 206(2), and 206(4) and Rule 206(4)-8 through his actions in selling clients, including four investment advisory clients,

[1] Citations to exhibits attached to the Division's opposition will be noted as "Div. Ex." Division Exhibits 1, 10, and 12 are comprised of Bates-stamped pages with the prefix "SFA." Citation to pages in those exhibits will omit the prefix and leading zeros. Thus, Division Exhibit 1 at SFA0001850 will be noted as "Div. Ex. 1 at 1850."

interests in vehicles to make charitable contributions consisting of conservation easements and thus obtain tax deductions.

For a violation of Securities Act Section 17(a); Exchange Act Sections 10(b) and 15(a) and Rule 10b-5; and Advisers Act Rule 206(4)-8,[2] the interests must be "securities" within the meaning of the federal securities laws. However, Advisers Act Sections 206(1) and 206(2) are not limited to fraud that is connected with securities transactions. A prohibited practice violates those sections if it defrauds or operates as a fraud or deceit on any advisory "client or prospective client."[3] This is clear from the plain meaning of the language of those provisions, as the Commission recognizes:

> Unlike other general antifraud provisions in the federal securities laws which apply to conduct "in the offer or sale of any securities" or "in connection with the purchase or sale of any security," the pertinent provisions of Section 206 do not refer to dealings in securities but are stated in terms of the effect or potential effect of prohibited conduct on the client. Specifically, Section 206(1) prohibits "any device, scheme, or artifice to defraud any client or prospective client," and Section 206(2) prohibits "any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." In this regard, the Commission has applied Sections 206(1) and 206(2) in circumstances in which the fraudulent conduct arose out of the investment advisory relationship between an investment adviser and its clients, even though the conduct does not involve a securities transaction.

Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Release No. 1092, 1987 SEC LEXIS 3487 at *25-26 (Oct. 8, 1987); s*ee also SEC v. Dibella*, No. 3:04-cv-1342, 2005 U.S. Dist. LEXIS 31762 at *22-23 (D. Conn. Nov. 29, 2005) (stating that Advisers Act Section 206(2) does not require proof that fraud was "in connection with the provision of investment advice").[4]

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[2] Advisers Act Rule 206(4)-8(a) prohibits fraudulent conduct by an investment adviser to a "pooled investment vehicle," and Rule 206(4)-8(b), through reference to Sections 3(a), 3(c)(1), and 3(c)(7) of the Investment Company Act of 1940 defines "pooled investment vehicle" as a security.

[3] Specifically, Section 206(1) makes it unlawful by jurisdictional means "to employ any device, scheme, or artifice to defraud any client or prospective client;" and 206(2), "to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

[4] The OIP alleges that LPL was unaware of the transactions. However, even if Lloyd sold the interests to advisory clients outside of his relationship with LPL, it cannot be questioned that the Commission has authority to bar persons from association with investment advisers, whether registered or unregistered, or otherwise sanction them under Section 203 of the Advisers Act. *Teicher v. SEC*, 177 F.3d 1016, 1017-18 (D.C. Cir. 1999).

This Order concludes that the interests that Lloyd sold were not securities. Whether he sold any such interests to advisory clients and engaged in prohibited practices in doing so remains at issue.

The parties agree on the structure of the transactions. After learning of conservation easements as a tax deduction, Lloyd recommended them to tax clients. For the transactions at issue, Lloyd learned from a promoter of potential transactions involving parcels of land for which a contribution of a conservation easement could be made so as to qualify for a charitable deduction from income pursuant to 26 U.S.C. § 170(h). Lloyd formed limited liability companies (LLCs), *e.g.*, Forest Conservation 2012, LLC,[5] to purchase interests in entities, *e.g.*, Piney Cumberland Holdings, LLC (Piney Cumberland), whose promoter had identified a parcel of undeveloped land that was suitable for a conservation easement. Lloyd bundled funds received from clients into each LLC which then purchased interests in the corresponding land-investment entity. Some of the clients to whom he sold interests in Forest Conservation 2012, LLC, were also investment advisory clients. Answer at 7 (admitting this in answer to OIP ¶ 32).[6] Thereafter, as planned, the land-investment entity would donate a conservation easement on the land to a qualified conservation organization, resulting in a tax deduction based on the difference between the land's value with and without potential development. The deduction flowed through the LLC and was available to Lloyd's clients on their income tax returns. The tax saving was expected to be greater than the amount each participant in the LLC paid. Answer at 2 (admitting OIP ¶ 2 insofar as it alleges that such a transaction can result in a tax deduction greater than the taxpayer's cost).

Piney Cumberland's offering materials are attached to the Division's opposition as Division Exhibit 1. They clearly show that the conservation easement donation was the purpose of the scheme. There had been preliminary negotiations with Foothills Land Conservancy to accept the conservation easement, and Piney Cumberland provided an estimated charitable contribution deduction amount.[7] Div. Ex. 1 at 1851. The offering materials discussed at length the proposed conservation easement and possible positive and negative results in a taxpayer's

[5] The other two LLCs at issue in which Lloyd placed his clients were Forest Conservation 2011, LLC, and Forest Conservation 2012 II, LLC. They invested in Maple Equestrian, LLC (Maple Equestrian), and Meadow Creek Holdings, LLC (Meadow Creek), respectively. The Meadow Creek land was adjacent to the Piney Cumberland land, within two miles of Fall Creek State Park in Tennessee, and the Maple Equestrian land was in DeKalb County, Alabama. Div. Ex. 1 at 1850, 1853; Div. Ex. 10 at 2259; Div. Ex. 12 at 427, 430.

[6] The OIP alleges, at ¶ 20, that Lloyd sold interests in Forest Conservation 2011, LLC, to ten tax clients, two of whom were advisory clients. However, Lloyd denied that the ten included any advisory clients. Answer at 5. There is no allegation that the clients to whom he sold interests in Forest Conservation 2012 II, LLC, included any advisory clients. *See* OIP at ¶ 54.

[7] The Maple Equestrian and Meadow Creek materials also provided estimated charitable contribution deduction amounts. *See* Div. Ex. 10 at 2259, 2265-66 (also identifying Maple Equestrian's land trust as North American Land Trust); Div. Ex. 12 at 397, 403-04 (also identifying Foothills Land Conservancy as Meadow Creek's land trust).

claiming a charitable deduction for it with the Internal Revenue Service (IRS).[8] *Id*. at 1857-70. The materials also included a thirty-page opinion letter from a lawyer concerning the conservation easement and tax consequences of donating it.[9] *Id*. at 1941-70. The materials recited steps taken and costs incurred in reference to the conservation easement, such as survey, appraisal and legal work, including sums paid and payable to Foothills Land Conservancy's legal counsel in reference to the conservation easement.[10] *Id*. at 1838-39. If a conservation easement had been granted and had been recorded for at least four years, management, in its sole discretion, could sell or otherwise dispose of the property, including by donating it to charity.[11] *Id*. at 1828.

The offering materials contained extensive disclosure concerning difficulties that participants might encounter in claiming their tax deductions for the conservation easement. Piney Cumberland set aside funds for audits of its returns and warned prospective participants of an increased risk of audit of the company and participants in relation to the conservation easement. For example, the Piney Cumberland's chosen appraiser had delivered numerous conservation easement appraisals for other clients, some of whose tax returns were audited by the IRS, as were the tax returns of others associated with Piney Cumberland, such as its lawyers, the land trust it had chosen, consultants and others.[12] *Id*. at 1820, 1831-32. In fact, the IRS had notified the appraiser that it intended to recommend a penalty against him for substantial valuation misstatement on an unrelated project that was audited.[13] *Id*. at 1835. Piney Cumberland warned of possible adverse consequences if the IRS rejected or reduced the conservation easement charitable deduction.[14] *Id*. at 1834.

While the offering materials show that the conservation easement donation was the purpose of the scheme, they did include a boilerplate warning of the possibility that the land might instead be held for development. *Id*. at 1841, 1845, 1857. The *pro forma* nature of this warning was underscored by making it clear that the funds to be raised would be insufficient to

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[8] The Maple Equestrian and Meadow Creek materials included a similar discussion. *See* Div. Ex. 10 at 2291-304, Div. Ex. 12 at 433-47.

[9] The Maple Equestrian and Meadow Creek materials included opinion letters from the same law firm. *See* Div. Ex. 10 at 2383-409, Div. Ex. 12 at520-49.

[10] The Maple Equestrian and Meadow Creek materials included similar disclosures. *See* Div. Ex. 10 at 2277-78, Div. Ex. 12 at 415-16.

[11] The Maple Equestrian and Meadow Creek materials included the same provision. *See* Div. Ex. 10 at 2268, Div. Ex. 12 at 406.

[12] The Maple Equestrian and Meadow Creek materials included similar warnings of the risk of audit. *See* Div. Ex. 10 at 2270-71, Div. Ex. 12 at 398, 409-10.

[13] The Maple Equestrian and Meadow Creek materials included the same disclosure. *See* Div. Ex. 10 at 2274, Div. Ex. 12 at 413.

[14] The Maple Equestrian and Meadow Creek materials included the same warning. *See* Div. Ex. 10 at 2274, Div. Ex. 12 at 412.

develop the land: the offering materials warned that development would require significant additional capital and that Piney Cumberland did not have such capital, any commitments for additional financing, or plans to pursue any opportunities for additional financing.[15] *Id*. at 1819, 1825-26.

The plain language of the offering materials is consistent with the expectations of the investors and the results of their investments. The participants in Lloyd's LLCs signed affidavits making clear that each one understood that his investment was for the purpose of a conservation easement and the consequent deduction from his taxes, as he was told by Lloyd. Ex. 8 to Lloyd's Motion for Summary Disposition. There can be no other interpretation from these facts than that the purpose of the investments was to obtain conservation easement tax deductions. Indeed, the OIP alleges that Lloyd sold the investments in Forest Conservation 2012, LLC, and the other LLCs to clients for the purpose of obtaining tax deductions based on conservation easements (while alleging that he engaged in misconduct while doing so). *See, e.g.,* OIP at ¶¶ 3, 16, 33.

The offering materials for Piney Cumberland and for Maple Equestrian, LLC, and Meadow Creek Holdings, LLC, in which Forest Conservation 2011, LLC, and Forest Conservation 2012 II, LLC, invested for the purpose of conservation easements, had the same or very similar terms. Div. Exs. 1, 10, 12.

Both parties analyzed the question of whether the interests that Lloyd sold were securities in terms of an "investment contract" within the meaning of Securities Act Section 2(a)(1) in light of *SEC v. W.J. Howey Co*., 328 U.S. 293 (1946). *Howey* established a four-element test: "[A]n investment contract . . . means a contract, transaction, or scheme whereby a person [(1)] invests his money [(2)] in a common enterprise and [(3)] is led to expect profits [(4)] solely from the efforts of the promoter or a third party." *Id*. at 298-99. Element (1) is clearly present as is element (2) in the form of horizontal commonality – the investors' funds were pooled in Forest Conservation 2012, LLC, which purchased units in Piney Cumberland.[16] However, element (3) is not satisfied. The purpose of participating through Forest Conservation 2012, LLC, in Piney Cumberland was to obtain tax deductions. This is clear from Piney Cumberland's offering materials, and it cannot be doubted that Lloyd's clients understood this, based on the affidavits and their status as tax clients. Even the OIP alleges that Lloyd sold the interests to his clients as tax deduction vehicles. The expectation of a tax deduction is not a "profit" under the *Howey* test. *Newmyer v. Philatelic Leasing, Ltd*., 888 F.2d 385, 393-94 (6th Cir. 1989) (citing *Randall v. Loftsgaarden*, 478 U.S. 647 (1986); *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975)).[17] The possibility that Piney Cumberland might not donate a

[15] The Maple Equestrian and Meadow Creek materials included the same warning. *See* Div. Ex. 10 at 2259, 2265-66, Div. Ex. 12 at 397, 403-04.

[16] *See Teague v. Bakker*, 35 F.3d 978, 986 n.8 (4th Cir. 1994) (supporting the horizontal commonality concept).

[17] The Division relies on *Newmyer*, which involved a scheme that was planned to result in both tax benefits and profits from the sale of stamps, in support of its contention that the interests at issue were securities. However, the court in that case stated, "tax benefits alone cannot satisfy the profit requirement." *Id*. at 394.

conservation easement or that a deduction might be disallowed is not "a clear expectation of eventual profit." That is, the possibility that the tax deduction plan might fail, leaving the LLCs with interests in undeveloped land, does not convert the loss of the anticipated tax savings into a profit. Nor, with respect to element (4), can it be said that the expected tax savings would result from the efforts of the promoter or a third party.[18]

In light of the above, the hearing will not go forward as to the charges of violation of Securities Act Section 17(a); Exchange Act Sections 10(b) and 15(a) and Rule 10b-5; and Advisers Act Rule 206(4)-8, in connection with all three of Lloyds' investment entities – Forest Conservation 2011, LLC; Forest Conservation 2012, LLC; and Forest Conservation 2012 II, LLC. However, material questions of fact as to the allegations of violation of Advisers Act Sections 206(1), 206(2), and 206(4) in connection with Forest Conservation 2012, LLC, remain. These include issues related to the alleged inconsistency between sums collected from participants and sums invested and the initial omission of three participants from the list of subscribers. Whether, as alleged in the OIP, any of the subscribers in Forest Conservation 2011, LLC, was an advisory client is at issue, but that is not material in the absence of any alleged violations of Advisers Act Sections 206(1), 206(2), or 206(4).

IT IS SO ORDERED.

/S/ Carol Fox Foelak
Carol Fox Foelak
Administrative Law Judge

[18] The expected tax savings would require forbearance by IRS examiners from disallowing or reducing deductions resulting from the conservation easement contribution, but it would be ludicrous to interpret such forbearance as "the efforts . . . of a third party."