UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

Case No. 20-CV-81205-RAR

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

COMPLETE BUSINESS SOLUTIONS GROUP, INC. d/b/a PAR FUNDING, *et al.*,

Defendants.
_____/

DEFENDANTS' REPLY IN SUPPORT OF MOTION FOR PARTIAL SUMMARY JUDGMENT

Defendants, Joseph LaForte, Lisa McElhone, and Joseph Cole Barleta ("Defendants") file this Reply in support of and respectfully move the Court to grant Defendants' Motion for Partial Summary Judgment (ECF No. 804) for the reasons set forth in said motion and below.[1]

1. The SEC Cannot Establish That Defendants Made a Materially Misleading Omission Regarding the Cease-and-Desist Orders Issued by Pennsylvania and New Jersey.

The SEC's Response reveals that its claim of a material omission involving the Pennsylvania and New Jersey cease-and-desist orders ("C&D Orders") must be dismissed on summary judgment. The SEC erroneously argues that "Defendants cite no evidence in support of their argument" (Response at 2). In fact, Defendants met their burden "by showing that there is an 'absence of evidence to support the non-moving party's case." *Jeffery v. Sarasota White Sox, Inc.*, 64 F.3d 590, 593 (11th Cir.1995). Where, as here, "the non-moving party bears the burden of proof at trial, the moving party may obtain summary judgment simply by establishing the nonexistence of a genuine issue of material fact as to any essential element of a non-moving party's claim or affirmative defense"—and does not have to "support its motion with affidavits or other similar material negating the opponent's claim." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323-324 (1986). Accordingly, Defendants discharged their burden in this situation by showing the Court that "there is an absence of evidence to support the [SEC's] case." *Id.* at 325. Having done so, the SEC bore the burden of proof in its Response to cite "to particular parts of materials in the record" or show "that the materials cited do not establish the absence or presence of a genuine dispute." Fed.R. Civ. P. 56(c)(1).

And the SEC did not meet its burden. The SEC was required to show that the alleged omission regarding the C&D orders *rendered another statement made by Defendants materially misleading*. This is because while the existence of a state cease and desist order may be relevant to a reasonable investor, *SEC v. Merchant Capital, LLC*, 483 F.3d 747, 771 (11th Cir. 2007), "Section 10(b) of the Exchange Act and Rule 10b-5 do not create an affirmative duty to disclose any and all material information." *In re Galectin Therapeutics, Inc. Secs. Litig.*, 843 F.3d 1257, 1274 (11th Cir. 2016). "Silence, absent a duty to disclose, is not misleading under Rule 10b-5." *Id.* Rather, Rule 10b-5 prohibits "omissions of material fact *'necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.*" *Id.* (Emphasis supplied).

[1] Notwithstanding the allegations in the Amended Complaint, Defendants accept the SEC's representation that Defendants' (1) "loan practices," including the amount of "interest" charged; and (2) alleged representations regarding Par Funding's possible insolvency before the exchange note offering are not part of its case. (Response at 13, 18.)

Here, the SEC has not alleged that Defendants had a duty to disclose the cease-and-desist orders and has produced no evidence that Defendants told investors that Par Funding had never been the subject of a cease-and-desist orders, because they did not. *Id.* Instead, the SEC alleged that Defendants' omission regarding the C&D orders rendered another statement—Par Funding's success as a profitable cash advance company—materially misleading. (Am. Compl., ¶ 227.) *Fries v. Oil & Gas, Inc.*, 285 F. Supp. 3d 706, 719 (S.D.N.Y. 2018) addresses the issue at hand here—the requisite connection necessary between an omission and a statement made by a defendant triggering a duty to disclose. *See Fried v. Stiefel Labs., Inc.*, 814 F.3d 1288, 1294 (11th Cir. 2016) ("[T]his Court has never held that a failure to disclose material information is an omission under subsection (b) absent a statement made misleading by that failure."). "Therefore, 'you can't have one without the other' – absent any omission, the statements would not be misleading, and absent any statements that were rendered misleading by the omission, the omission by itself would not be actionable." *MAZ Partners LP v. First Choice Healthcare Sols., Inc.*, No. 6:19-CV-619, 2019 WL 5394011, at *9-10 (M.D. Fla. Oct. 16, 2019).

In *Fries*, a company's CEO was investigated by the SEC for securities laws violations and, like Defendants here, was the subject of a cease-and-desist order. *Id.* at 712. The plaintiff in *Fries* alleged that the defendants' failure to disclose this conduct rendered the company's statements touting the CEO materially misleading. *Id.* at 719. The court explained that "the requisite connection triggering a duty to disclose" arises in the following three circumstances:

> (1) when a corporation puts the reasons for its success at issue, but fails to disclose that a material source of its success is the use of improper or illegal business practices; (2) when a defendant makes a statement that can be understood, by a reasonable investor, to deny that the illegal conduct is occurring; and (3) when a defendant states an opinion that, absent disclosure, misleads investors about material facts underlying that belief.

Id., citing In re Virtus Inv. Partners, Inc. Sec. Litig., 195 F.Supp.3d 528, 536 (S.D.N.Y. 2016). Because the omission of the CEO's conduct—including the SEC cease-and-desist order—did not render the defendants' statements touting the CEO misleading (and the statements made did not deny that the illegal conduct was occurring), the court held that there was no actionable misstatement or omission. *Id.* at 719-720.

Similarly, the SEC in this case has failed to point to any evidence demonstrating that the C&D orders they allege Defendants omitted had any connection to—much less *were a material source* of—Par Funding's success. And because the SEC cannot point to a single statement made by Defendants

denying the existence of the C&D Orders, its claim of a material omission must be dismissed.[2] *MAZ Partners LP*, 2019 WL 5394011, at *9-10 (M.D. Fla. Oct. 16, 2019) (statement that CEO was key to company's success not rendered materially misleading by omission of corporate misconduct, the CEO's involvement in a market manipulation scheme, *even though the court agreed that the market manipulation scheme would have been relevant to a reasonable investor.*)[3]

The SEC's Response also makes clear that Defendants did not act with scienter in connection with this alleged omission. The SEC has failed to point to any evidence demonstrating that the Defendants knew or understood that they had an obligation to disclose the C&D Orders to investors. There is no evidence of an effort to conceal this information from investors and, as explained above, there is no evidence that Defendants ever told investors that Par Funding had never been the subject of any such Orders. While the SEC prefers to argue based on an adverse inference that Lisa McElhone "admitted" Par Funding never sought legal advice regarding whether to disclose its regulatory history,

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[2] Instead, recognizing that they have no such evidence to offer, the SEC points to evidence that "LaForte not only falsely claimed there were no such restrictions, but tied it directly to Par Funding's success and then omitted the fact that two separate state regulatory organizations had already sanctioned Par Funding for violating securities laws in connection with raising investor capital." (Response at 3.) This loose reference to a statement regarding "restrictions" being "tied to Par Funding's success," of course, is not evidence that the C&D Orders were tied to Par Funding's success and is not evidence that Defendants stated that they were not the subject of C&D Orders or regulatory investigations. Beyond the fact that this reference to a statement about "restrictions" was not the subject of Defendants argument on summary judgment, it is not even alleged in the Amended Complaint. This court should not permit the SEC to move the goalposts yet again, as they have done repeatedly in this case. *See Richards v. Headley*, No. 2:19-CV-845-KFP, 2021 WL 2784278, at *5 (M.D. Ala. July 2, 2021) ("Plaintiff's summary judgment response is not an elaboration of evidentiary details; it is an impermissible attempt to 'move the goalposts' by substituting an entirely new factual predicate for his claims at the summary judgment stage"); *Wilcox v. Green Tree Servicing, LLC*, No. 8:14-CV-1681-T-24, 2015 WL 2092671, at *1 (M.D. Fla. May 5, 2015) (finding that "the court could only consider the claims and theories of liability that plaintiff actually pled in her complaint," and thus, the court could not consider additional facts raised by the plaintiff for the first time in response to a summary judgment motion) (collecting authorities).

[3] Beyond the fact that *Merchant Capital* is inapposite because it only reaches the question of materiality and not the duty to disclose at issue here, it is also distinguishable on the issue of materiality. There, the court held that "the existence of a state cease and desist order" was relevant to a reasonable investor because the defendants continued selling "*identical instruments*" after having received the order. 483 F.3d at 771, n. 22 (emphasis added.) It is undisputed here that Par Funding hired counsel, Phillip Rutledge, to change the way it sold notes using a new instrument—a note purchase agreement drafted by Rutledge for that purpose. Evidence of the new instrument used by Par Funding was not considered by the Court on Defendants' Motion to Dismiss, which was decided solely on the allegations of the Amended Complaint. *See Barberi v. Luisi Dollar Discount Mini Market, Inc.*, No. 17-20522-CIV, 2017 WL 2651710, at *3 (S.D. Fla. 2017) (permitting re-argument of issue at summary judgment stage after denial on motion to dismiss "with the benefit of a more complete record.)

the actual undisputed evidence in the record proves otherwise. *See Rivera v. Guevara*, 319 F.Supp.3d 1004, 1040 (N.D. Ill. 2018) ("defendants' summary judgment cannot be denied solely because one defendant has exercised his Fifth Amendment right any more than the question of liability for damages could be sent to the jury on that basis alone.") Defendants hired counsel to deal with the Pennsylvania investigation and sought his assistance in how to legally continue selling notes to investors, which would include necessary disclosures.

The SEC offers nothing to dispute these facts; instead, it argues that Defendants are asking the Court to weigh the evidence. But the SEC, who has the burden of proving scienter, has offered no contrary facts on this point for the Court to consider. It has offered no evidence that Defendants knew they had to disclose the C&D Orders.[4] The SEC even goes so far as to invite this Court to speculate as a basis to deny summary judgment: "Had Par Funding hired Mr. Rutledge to draft its disclosure documents in 2018 or 2019 (after a regulatory Order was entered), then *he would have advised Par Funding to disclose the regulatory history*." (Response at 5.) *Parker v. Wal-Mart Stores E., LP*, No. 1:16-CV-1479-ODE, 2018 WL 9437354, at *4 (N.D. Ga. Aug. 23, 2018), *aff'd*, 769 Fed. Appx. 875 (11th Cir. 2019) ("[m]ere speculation is not enough to rebut contrary evidence, and for an inference to create a genuine issue of material fact that is enough to defeat a motion for summary judgment, the inference must be based upon evidence 'which is [not] too uncertain or speculative or which raises merely a conjecture or possibility.'") It offers no actual evidence that Defendants did not seek this opinion from counsel or that Rutledge advised Par to disclose the regulatory history. Its only attempt in this regard is a reference to an adverse inference,[5] which cannot alone rebut Defendants' evidence that they sought counsel from Rutledge. Indeed, the SEC's evidence makes clear that Defendants disclosed the C&D Orders and another investigation brought by Texas as soon as they were advised to do so by counsel. These unrebutted facts alone undermine any *reasonable argument* that Defendants concealed the C&D Orders with scienter. *Daniels v. Twin Oaks Nursing Home*, 692 F.2d 1321, 1326 (11th Cir. 1982) (inference must be "reasonable" to defeat a motion for summary judgment).

[4] The SEC erroneously represents that paragraphs 37, 47, and 61-75 of its Opposition to Defendants' Statement of Facts (ECF No. 887-1) support the proposition that Rutledge told Defendants "that if Pennsylvania entered an Order against Par Funding, then it could give rise to a disclosure requirement."

[5] The SEC points this Court to a request for Admission that Ms. McElhone, through inadvertence, did not initially answer, but has answered through an invocation of her 5th Amendment Rights. (*See* ECF No. 914.)

2. Defendants Did Not Engage in a Scheme to Defraud Pennsylvania Regulators.

The SEC's repeated efforts to play fast and loose with the evidence should be cause for the Court's concern. Not only is there no evidence that "LaForte decided to implement the Agent Fund," the record (including the SEC's own Amended Complaint), makes clear that Vagnozzi conceived the idea and implemented it with assistance from *his* attorney, John Paucioulo. (*See* ECF No. 895, ¶¶ 132-136). The SEC's desire to involve LaForte in a decision the undisputed evidence demonstrates was conceived and implemented by Vagnozzi and his attorney is not evidence. Even assuming LaForte "knew about the Agent Fund model for years" – his knowledge does not take the place of evidence that he or anyone at Par Funding *implemented this model to deceive Pennsylvania regulators*. There is simply no evidence of this, and the SEC cites none in its Response. Instead, it argues, forgetting it is the Plaintiff, that Defendants "cite no evidence other than the fact that Vagnozzi previously proposed the Agent Fund…" The SEC is wrong for several reasons.

First, Defendants met their burden on summary judgment by showing that there is an absence of evidence to support the SEC's case on the issue of scienter. *See Sarasota White Sox, Inc.*, 64 F.3d at 593. The SEC bore the burden of proof in its Response to cite "to particular parts of materials in the record" that LaForte or some other Defendant implemented this plan with the intent to deceive regulators, *see* Fed.R. Civ. P. 56(c)(1), and failed to do so. Second, the SEC is simply wrong in arguing that the Defendants failed to support their argument that Vagnozzi conceived and implement the idea with the assistance of his lawyer. (See ECF No. 895, ¶¶ 132-136). Third, the SEC is conflating the advice of counsel defense with Defendants' argument that they had a good faith belief that Vagnozzi's lawyer, Pauciulo, had set up the Agent Funds in a manner compliant with the law. As the court noted in *Howard v. SEC*, 376 F. 3d 1136, 1147-48 (D.C. Cir. 2004), the SEC knows better than to confuse those distinct ideas. Defendants bear no burden to prove their good faith, as it is the SEC's burden to disprove that they acted in good faith, and evidence relevant to a defendant's good faith always is admissible. *Id.* The SEC's assertion that a defendant must satisfy the elements of the wholly separate advice-of-counsel defense before he can refer to the role played by lawyers or consultants is a fiction that courts have rejected repeatedly. *Id.*; *see also S.E.C. v. Snyder*, 292 Fed.Appx. 391, 406 (5th Cir. 2008); *S.E.C. v. Prince*, 942 F. Supp. 2d 108, 138 (D.D.C. 2013). The evidence demonstrates that Defendants were not experienced or knowledgeable about and did not even come up with the idea for the Agent Fund model. To overcome this glaring problem, the SEC is asking this Court to draw an unreasonable inference from the evidence—that LaForte's mere knowledge that Vagnozzi and his lawyer planned to create the Agent Funds is somehow proof that he not only implemented the model but did so to

deceive Pennsylvania regulators. *See Daniels,* 692 F.2d at 1326 (11th Cir. 1982) (inference must be "reasonable" to defeat a motion for summary judgment).

3. The SEC Cannot Prove That Defendants Misled Investors Regarding the Default Rate.

In an effort to make the argument that Defendants made a materially misleading statement about the default rate, the SEC once again ignores "the total mix of information" made available to investors in favor of its own version of what investors were told. Defendants provided investors with a monthly CBSG Funding Analysis Reports including a default rate calculation. The SEC's argument that "the Financial Analysis Report does not reflect the default rate on the MCA loans at all" (Response at 8), ignores the reports themselves. The calculation in the reports included a footnote defining the default rate as "Factoring Losses realized in respective month equal to total AR balance for transactions *written off* against *Factoring Loss reserve*." (ECF No. 805, Exhibit 3, n. 4) (emphasis supplied.) Amounts written off against receivables *are* amounts in default.[6] *See Matter of Federated Dept. Stores, Inc. and Allied Stores Corp.*, WL 10858840, *5 (S.D. Ohio 1990) (citing to an agreement defining "Defaulted Receivable" as a Receivable that is written off the Purchaser's or the applicable Seller's books as uncollectable.") The SEC's own interpretation of default cannot trump or take the place of Defendants' actual, written representations to investors. This would be true even if someone who receives the report believes it to mean something else. In *Carr v. CIGNA Securities, Inc.*, Judge Posner explained that:

> If a literate, competent adult is given a document that in readable and comprehensible prose says X (X might be, "this is a risky investment"), and the person who hands it to him tells him, orally, not-X ("this is a safe investment"), our literate, competent adult cannot maintain an action for fraud against the issuer of the document. This principle is necessary to provide sellers of goods and services, including investments, with a safe harbor against groundless, or at least indeterminate, claims of fraud by their customers. Without such a principle, sellers would have no protection against plausible liars and gullible jurors ... If the documents he was given, warning him in capitals and bold face that it was a RISKY investment, do not preclude the suit, it will simply be his word against the seller's concerning the content of an unrecorded conversation.

[6] See Paragraph 35 of Expert Report of Melissa Davis, in which she writes, "Par Funding made periodic adjustments to the Merchant Advance Receivables to reduce it for Merchant Advances *that it deemed were in default* and likely not collectible. *These transactions were recorded as factoring losses expense*, ('Factoring Loss') on Par Funding's profit and loss statement and resulted in a reduction to the Merchant Advance Receivables."

95 F.3d 544, 547 (7th Cir.1996). Because the SEC does not challenge the accuracy of the default rate reported to investors, its claim that Defendants misled investors with scienter regarding the default rate reported in the Funding Analysis Report it provided investors on a monthly basis cannot stand.

4. Defendants Conducted the Underwriting Represented to Investors.

The SEC forgets that statements must be materially misleading and made with scienter to be actionable. It concedes that Par Funding's approved just 17% of merchant application, yet somehow argues that "this says nothing about what underwriting was actually done." (Response at 10.) The SEC offers no evidence to rebut the fact that Par Funding's underwriting efforts and guidelines resulted in the rejection of roughly 83% of merchant applications, far more than the industry standard, or that it had an entire department dedicated to this task, which included background checks, on-site inspections, and credit and financial verifications. Based on this record, the SEC cannot meet its burden to prove that Par Funding's representations regarding its underwriting were *materially* misleading, as any discrepancies raised by the SEC pale in comparison to the mountain of undisputed evidence that the Company maintained rigorous underwriting standards.

With respect to the claim of on-sites, the SEC erects a strawman to suggest that Defendants "pivot and argue without support that on-site inspections are not necessary." (Response at 11.) The SEC knows better. Certainly, had Defendants represented to investors that on-site inspections were done when they were never, or rarely done, that would be misleading and material to the reasonable investor. But a reasonable investor would not alter their investment decision simply because on-sites were not repeated for merchants with which Par Funding had a pre-existing relationship, or that other measures were taken to verify the existence of businesses like law firms and child-care centers, where on-sites were not possible. The only material element to the underwriting is that all the proper documents are collected and analyzed, and an informed underwriting decision is made, particularly given the SEC's concession that Par Funding operated an underwriting department that rejected more merchant applications than the industry standard.[7]

5. Par Funding Believed in Good Faith That It Had the Insurance Coverage It Represented to Investors.

The record is clear that Defendants believed that Par Funding had insurance to cover merchant defaults. In yet another desperate effort to undermine clear evidence, the SEC attempts to

[7] The SEC misstates the testimony of Victoria Villarose in its Opposition to Defendants' Statement of Undisputed Facts. The SEC's exhibits do not support its contention that on-sites were not done at all.

argue that while Anthony Bernato, Par Funding's insurance broker understood that Par Funding's insurance carrier misrepresented the insurance they sold to Par Funding, he may not have told Defendants, his clients, about it. (Response at 12: "Bernato's declaration says nothing of what he told Defendants…") This is non-sensical. Bernato was Par Funding's broker and testified in his declaration that he believed Par Funding's assertions regarding the insurance they purchased from Euler Hermes to be true. *See* Exhibit 25, Declaration of Anthony Bernato, at ¶¶ 5-6. Moreover, when Defendants learned for the first time that the insurance they purchased might not cover what the carrier represented to them, they immediately advised the Agent Fund Manager who was selling notes to investors on the promise of insurance about the lack of coverage, *and asked him to stop*. There is simply no evidence that Defendants represented that Par Funding had insurance in connection with the purchase or sale of security after this point, and the SEC does not cite to any contrary evidence. Thus, the record clearly reflects that Defendants acted in good faith with respect to representations they made to investors, which is all that matters in an SEC enforcement action.

6. LaForte's Criminal History

The SEC somehow concedes that Defendants received legal advice that disclosing LaForte's criminal history to investors wasn't necessary under SEC Rule 502(b), but that the omission was still material to investors and made with scienter. The SEC maintains Defendants acted with the intent to defraud investors despite this advice because of the timing of the disclosure. But the SEC ignores the undisputed evidence that Defendants held a reasonable belief based on advice they received from counsel they hired before Rutledge, Lisa Jacobs, that the Phase 1 notes were not securities. ECF No. 896-13, pp. 177-178. Rutledge himself argued to Pennsylvania regulators that the Phase 1 notes were not securities, *see id.*, and therefore not subject to the disclosure requirements of the securities laws. It is therefore clear that Defendants believed based on advice they received from Jacobs, before consulting Rutledge, that they had no duty of disclosure to Phase 1 investors. When they sought Rutledge's advice regarding this disclosure as to Phase 2 investors, he advised them—as the SEC concedes—that it was not required.

The context of Rutledge's advice on this point bears repeating. Defendants hired Rutledge to advise them regarding *the continued sale of notes* following the conclusion of the Pennsylvania investigation, which obviously includes disclosures necessary to make those sales compliant with the securities laws. In connection with this representation, Rutledge advised Defendants – and represented to Pennsylvania regulators – that Par Funding's Phase 1 and Phase 2 investors were accredited and, accordingly, that disclosures regarding management did not need to be made to accredited investors.

Because Rutledge took the position with Pennsylvania Regulators (and advised Defendants of the same), that Par Funding's Phase 1 investors were accredited, his advice would apply to them as well.

Undaunted, the SEC next asks the Court to ignore Rutledge's legal advice because they claim Defendants did not disclose LaForte's position to Rutledge. But the record is clear that Rutledge knew LaForte had "oversight" over Par Funding's affairs when Rutledge provided this advice to Defendants. ECF No. 896-12, pp. 36-38. Rutledge therefore understood, because Mr. Cole disclosed it to him, that while LaForte was operating a separate company which provided sales leads to Par Funding, he had oversight authority over certain aspects of Par Funding's business. *Id.* Notably, Rutledge counseled Par Funding to amend Form D—which includes disclosures regarding the company's management—*after* he was aware that LaForte had this oversight and did not advise Defendants to disclose LaForte in the Form D filing.[8] Consequently, Rutledge legal advice to Defendants negates any reasonable inference that they omitted this information from investors with scienter.

[8] Defendants' exhibits filed in support of their Partial Motion for Summary Judgment support a finding that Defendants disclosed the Texas cease-and-desist letter. At a minimum, Defendants discussed this matter with Rutledge and believed he had included the disclosure in the Exchange Notes.

CONCLUSION

WHEREFORE, the Defendant, Joseph LaForte, Lisa McElhone, and Joseph Cole Barleta respectfully request that this Court grant the Partial Motion for Summary Judgment, ECF No. 804.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been filed on the Court's CM/ECF system which will serve a copy on all counsel of record via notices of electronic filing.

Respectfully submitted,

FRIDMAN FELS & SOTO, PLLC
2525 Ponce de Leon Boulevard, Suite 750
Coral Gables, FL 33134
Telephone: 305-569-7701
asoto@ffslawfirm.com
Attorneys for Joseph W. LaForte

/s/ Alejandro O. Soto
ALEJANDRO O, SOTO, ESQ
Florida Bar No. 172847

KOPELOWITZ OSTROW FERGUSON WEISELBERG GILBERT
One W. Las Olas Blvd., Suite 500
Fort Lauderdale, Florida 33301
Attorneys for Joseph W. LaForte

By:*/s/ Joshua R. Levine*
DAVID L. FERGUSON
Florida Bar Number: 0981737
Ferguson@kolawyers.com
JOSHUA R. LEVINE
Florida Bar Number: 91807
Levine@kolawyers.com
ALEXIS FIELDS
Florida Bar Number: 95953
Fields@kolawyers.com

/s/ Bettina Schein
Bettina Schein, Esq.

LAW OFFICES OF ALAN S. FUTERFAS
565 Fifth Avenue, 7th Floor
New York, New York 10017

/s/ Alan S. Futerfas
ALAN S. FUTERFAS
Telephone: 212- 684-8400
asfuterfas@futerfaslaw.com
Attorneys for Lisa McElhone
Admitted Pro Hac Vice

Attorney for Joseph Cole Barleta
565 Fifth Avenue, New York, New York 10017
(212) 880-9417
bschein@bettinascheinlaw.com
Admitted *Pro Hac Vice*