

STATE OF ALABAMA
ALABAMA SECURITIES COMMISSION

IN THE MATTER OF:)
)
STALWART CAPITAL LLC)
DOUGLAS CRAIG EVANS)
DON PAUL CLOUD) ADMINISTRATIVE ORDER
) NO. SC-2014-00 11
)
RESPONDENTS)

SHOW CAUSE ORDER

The Alabama Securities Commission ("Commission"), having the authority to administer and provide for the enforcement of all provisions of Title 8, Chapter 6, Code of Alabama 1975, the Alabama Securities Act ("Act"), upon due consideration of the subject matter hereof, has determined as follows:

RESPONDENTS

1. **STALWART CAPITAL LLC ("STALWART")** has been registered in the state of Alabama, as a broker/dealer since February 24, 2010, (Central Record Depository ("CRD") #149882) with a business address of 132 CENTRAL AVENUE, HILLSDALE, NJ 07642.

2. **DOUGLAS CRAIG EVANS ("EVANS")**, CRD# 2176863, for the relevant time of January 03, 2012 to May 22, 2014, was the Managing Principal for **STALWART** with a principal business address of 132 CENTRAL AVENUE, HILLSDALE, NJ 07642.

3. **DON PAUL CLOUD ("CLOUD")**, CRD# 5362093, for the relevant time of January 03, 2012 to May 22, 2014, was a registered agent of **STALWART** with a principal business address of 809 SHONEY DRIVE, SUITE 203, HUNTSVILLE, AL 35801.

STATEMENT OF FACTS

4. On September 21, 2012, Commission staff received a referral from the Securities and Exchange Commission's (SEC) New York Regional Office. The referral detailed concerns relating to the sales practices of **CLOUD** and the supervision by **STALWART**. Ultimately, the

New York Regional office of the SEC conducted an onsite examination for **STALWART** on June 7, 2012. During this examination, the SEC examiner noted several instances where **CLOUD** sold shares of Inland Diversified Real Estate Trust, Inc. (Inland) in which the sales exceeded ten percent of investor's liquid net worth. Per Alabama Securities Commission standards, the suitability parameter for selling of shares into Real Estate Investment Trusts (REIT's) includes not selling over ten percent of the investor's liquid net worth in any one sponsored program. Alabama Securities Commission mandates that sponsors of a REIT include the following language in each prospectus: "In general, each investor must have either: (i) minimum net worth of at \$250,000; or (ii) minimum annual gross income of at least \$70,000 and a minimum net worth of at least \$70,000." (Calculation must exclude investors home, automobile and home furnishings.) Additionally, prospectuses state: "Alabama, Iowa, Michigan and Ohio – In addition to meeting the applicable minimum suitability standards set forth above, your investment in us and our other sponsored real estate programs may not exceed 10% of your liquid net worth, which is defined as the remaining balance of cash and other assets easily converted to cash after subtracting the investor's total liabilities from total assets."

5. On January 10, 2013, the Commission staff conducted an on-site examination into the business practices of **CLOUD** at Cloud Financial Services. The focus of this examination was verification of the account holdings for each client of **CLOUD** to determine the concentration of REIT shares within the client portfolios. Additionally, the Commission Staff focused on the supervision of **CLOUD** by **STALWART**. During this review, the Commission staff noted three REIT's were being utilized: (1) Inland Diversified Real Estate Trust, Inc. (Inland), (2) Griffin Capital Net Lease (Griffin Capital) and (3) Griffin Healthcare REIT (Griffin Healthcare). At the time of the examination, these were the only three REIT's **STALWART** had approved for their agents to solicit and sell. The Commission staff noted the above referenced language concerning the ten percent rule was evident in the prospectuses of Griffin Capital, Griffin Healthcare and Inland. **CLOUD** produced financial questionnaires that list assets owned by each investor, but failed to include liabilities. The investor's liquidity was not clearly documented in writing at the time of transaction.

6. The following is an overview of Cloud Financial Services, Inc. and the business

practices of **CLOUD**: Cloud Financial, Inc. operates as a pass through organization that allows **CLOUD** to provide his clients insurance services, investment advisory services and broker dealer services in one location. **CLOUD** is appointed with numerous Companies to produce Accident, Health and Life Policies. During an interview with **CLOUD**, he stated the primary focus of his insurance business is to write Life policies, and that he writes limited amounts of fixed index annuities and fixed annuities. The investment advisory business is performed under Horts Investment Management, LLC (**HORTER**) (CRD# 119880), for which **CLOUD** is an investment adviser representative. The investment advisory business produces the bulk of revenue for Cloud Financial Services, Inc. **CLOUD** acts as solicitor for **HORTER**, who has contracted with various third party money managers to provide clients of **HORTER** with several options for managed portfolios. **CLOUD** is paid a quarterly fee of one percent (1%) of each client's assets under management. Additionally, **CLOUD** acts as a registered agent for **STALWART**. Per **CLOUD**, this portion of business is commission based and is utilized to provide clients securities brokerage service. **STALWART** markets mutual funds and placement of private securities. **CLOUD** utilizes the relationship with **STALWART** primarily for the sale of Non-Traded REIT shares and mutual funds. As of January 10, 2013, the mix of transactions through **STALWART** was approximately \$700,000 in Non-Traded REITs and \$15,000 in PIMCO mutual fund.

7. At the time of the examination, **CLOUD** had thirty-one Non-Traded REIT transactions, which consisted of sales of either Griffin Capital or Griffin Healthcare to twelve investors and Inland to nineteen investors. The Commission staff analyzed investor new account forms. **STALWART** new account forms were reconciled with the new account forms from Griffin Capital, Griffin Healthcare and Inland, which notate the amount of shares and purchase price. The Commission staff calculated the investor's percentage of liquid net worth ratios utilizing the high end of the stated liquid net worth on the **STALWART** new account form.¹

8. Based on the analysis conducted, the Commission staff sent a deficiency letter to **STALWART** on July 22, 2013 citing the failure to adhere to the net worth restrictions relating

¹ For example, if the stated liquid net worth was \$50,001 - \$200,000, Commission staff utilized \$200,000 for the ratio.

to the sale of Non-Traded REITs.

9. On August 15, 2013, **STALWART** responded to the Commission's July 22, 2013.² The response indicated that Stalwart's methodology for determining liquid net worth was not consistent with FINRA rules and other industry standards.

10. On November 20, 2013, the Commission staff contacted **CLOUD** via telephone to request additional information pertaining to liquid holdings of each of the investors. On December 5, 2013, the Commission staff received the requested information.

11. On January 3, 2014, the Commission staff sent a visitation letter to **HORTER** and requested investor new account information and account holding for 2012 and 2013. The Commission staff received the requested information on January 27, 2014 and February 18, 2014, respectively from **HORTER**.

12. The Commission staff reviewed the above referenced investor holdings at **HORTER** and noted that the majority of accounts were Individual Retirement Accounts (IRA). Additionally, the response from **CLOUD** indicated the inclusion of retirement accounts and other illiquid assets in his calculation of Liquid Net Worth utilized for the above referenced investors.

CONCLUSIONS OF LAW

13. Pursuant to Section 8-6-3(j)(2), Code of Alabama 1975, the Commission may suspend, revoke, censor or bar any registrant or any officer, director, partner or person occupying a similar status or performing similar functions for a registrant, from employment with a dealer or investment advisor, or restrict or limit a registrant as to any function or activity of the business for which registration is required in this state if the Commission finds that the order is in the public interest and that the registrant or, in the case of a dealer or investment advisor, any

² The definition on the **STALWART** new account form for Liquid Net Worth is: "Liquid net worth is your net worth minus assets that cannot be converted quickly and easily into cash, such as real estate, business equity, personal property and automobiles, expected inheritances, assets earmarked for other purposes, and investment accounts subject to substantial penalties if they were sold or if assets were withdrawn from them."

partner, officer or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the dealer or investment advisor has violated or failed to comply with any provision of the Alabama Securities Act, or any rule issued by the Commission.

Specifically, Commission Rule 830-X-3-.12 states, “Every dealer, investment adviser and every associated person thereof who recommends to a customer the purchase, sale or exchange of any security shall have reasonable grounds to believe and shall believe that the recommendation is suitable for such customer on the basis of information furnished by such customer after reasonable inquiry concerning the customer’s investment objectives, financial situation and needs, and any other information known by such dealer, investment adviser or associated person thereof.” **CLOUD** offered and sold Non-Traded REIT’s to customers in excess of the restrictions enumerated in the prospectuses. The Non-Traded REIT’s were sold in denominations that met or exceeded ten percent of each investor’s liquid net worth. **STALWART** and **CLOUD** sold securities to clients in concentrations which were unsuitable in light of the client’s liquid net worth in violation of the Act.

14. Pursuant to Section 8-6-3(j)(10), Code of Alabama 1975, the Commission may suspend, revoke, censor or bar any registrant or any officer, director, partner or person occupying a similar status or performing similar functions for a registrant, from employment with a dealer or investment advisor, or restrict or limit a registrant as to any function or activity of the business for which registration is required in this state if the Commission finds that the order is in the public interest and that the registrant or, in the case of a dealer or investment advisor, any partner, officer or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the dealer or investment advisor has failed reasonably to supervise his agents or employees if he is a dealer. **STALWART** and **EVANS** failed reasonably to supervise their agents or employees by allowing unsuitable transactions of Non-Traded REIT’s in denominations that met or exceeded ten percent of each investor’s liquid net worth in violation of the Act.

This Order is appropriate in the public interest for the protection of investors and consistent with the purposes of the Act.

This Order does not prevent the Commission from seeking such other civil or criminal remedies that may be available to it under the Act.

ACCORDINGLY, IT IS HEREBY ORDERED that **RESPONDENTS SHOW CAUSE** to the Commission within 28 days of the date of this **ORDER**, why **RESPONDENTS** should not be suspended, revoked, censored or barred from the securities industry in the state of Alabama.

Entered at Montgomery, AL, this 23rd day of May,
2014.



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BY:

Joseph P. Borg
Director