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UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. SECURE INVESTMENT SERVICES, INC., AMERICAN FINANCIAL SERVICES, INC., LYNDON GROUP, INC., DONALD F. NEUHAUS, and KIMBERLY A. SNOWDEN, Defendants.	Case No. 2:07-cv-01724-LEW-CMK PLAINTIFF'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF APPLICATION FOR TEMPORARY RESTRAINING ORDER AND ORDER TO SHOW CAUSE REGARDING PRELIMINARY INJUNCTION

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I. Introduction

Hundreds of investors – many of them elderly people with retirement savings at risk – are being defrauded by Donald F. Neuhaus, Kimberly A. Snowden, and three corporations they control (collectively, "Defendants"), through a "ponzi scheme" that projects profits exceeding 100%. In actuality, Defendants are using the scheme to misappropriate the investors' money by diverting funds to themselves and to similar, but unrelated, investments.

Defendants have raised at least $25 million by offering investors the opportunity to become fractional owners and beneficiaries of a large life insurance policy – a so-called "bonded life settlement." Defendants tell investors that they will receive the policy benefits when the insured on the policy dies, and provide investors with a written estimate showing that the insured is expected to live just a few more years. Defendants also pledge that if the insured should outlive the estimated life expectancy, then a bond purchased by Defendants will pay investors the policy benefit.

With such promises, Defendants may raise up to $2 million from investors for a particular policy. Defendants tell the investors that enough of their money will be set aside to cover premiums on that policy until the end of the life expectancy plus an extra 12 months for the bond to pay out, if necessary. Defendants therefore promise safe investments in which future premiums are covered and investors can count on a return either through the insured's death within the life expectancy, or at the latest, through the bonding company pay-out within 12 months of end of the life expectancy.

But instead of reserving funds from each investor to pay premiums on that investor's policy, Defendants use the investor's funds to pay the premiums coming due on ***other*** policies owned by ***other*** investors to prevent those ***other*** policies from lapsing and becoming worthless. (See Segner Decl. Par. 6, 8; Goldsholle Decl. Par. 14.) Defendants have also diverted $740,000 in investor funds to Mr. Neuhaus and Ms. Snowden. As a result, each new investor faces the immediate and undisclosed risk that the future premiums on ***his or her*** policy will go unpaid – and the investor's policy will therefore lapse – because Defendants have failed to set aside sufficient funds as promised. Having spent the investor money as they received it, Defendants

were $3 million short on June 30, 2007 of what they needed to reserve to cover future premiums. (Segner Decl. Par. 24.)

Besides false promises about premium reserves, Defendants misrepresent the investment in other ways. The life expectancy estimates supposedly reflect a physician's projection of how long the insured will continue to live, and by extension, project how long investors may have to wait for a return. As Defendants knew or were reckless in not knowing, the main providers of the estimates are an individual who falsely represented himself to be an M.D. and two companies he controls. Also, the estimates have been consistently understated, with many insureds alive today beyond the projected period. The bonding companies chosen by Defendants are unlicensed in the United States and have been charged in multiple proceedings brought by state regulators. Indeed, one bonding company has refused to honor bonds on over 20 policies.

Having depleted the prior investors' funds, Defendants are presiding over a scheme that must find new victims to keep operating. In fact, within the past few weeks, Defendants used $250,000 set aside to purchase a large policy for one group of investors in order to pay off partially another group of investors. (Baer Decl. Par. 11.) To protect existing investors and prevent new ones from being victimized, the Court should grant immediate preliminary relief. Plaintiff Securities and Exchange Commission ("Commission") therefore applies to the Court for a temporary restraining order to prohibit Defendants' continued fraudulent sales and misuse of investor proceeds. The Commission also requests a freeze on all of Defendants' assets, along with an order directing Defendants to provide an accounting, to preserve documents, and to comply with expedited discovery. Finally, the Commission requests the appointment of a receiver over the corporate entity Defendants so that all remaining assets can be marshaled for the benefit of investors.

II. Statement of Facts

A. Defendants' Scheme For Selling Fractional Interests In Insurance Policies

Donald F. Neuhaus ("Neuhaus") and his daughter, Kimberly A. Snowden ("Snowden"), have used three corporations, Secure Investment Services, Inc. ("SIS"), American Financial Services, Inc. ("AFS"), and Lyndon Group, Inc. ("Lyndon Group") (the "corporate defendants"),

to operate their fraudulent scheme at various times. All three corporations have their principal places of business in Redding, California. (Eme Declaration Exh. 1 at 7-8, 22-25, 87, Exh. 2 at 8-10, 16, 20, Exh. 34.) Together with his wife, Neuhaus owns the corporate defendants. (Eme Decl. Exh. 1 at 21, 24-25, Exh. 2 at 15, 20-21.)[1]

Neuhaus has served as an officer and/or director for each of the corporate defendants and controls them along with Snowden. (Eme Decl. Exh. 1 at 21-26, Exh. 2 at 10-11, 17-19, 64, Exh. 34.) Snowden has served as an officer and/or director for each of the corporate defendants and also as their Director of Operations and Controller. (Eme Decl. Exh. 2 at 10-11, 17-19, 64, Exh. 34.)

Since at least 2001, Defendants have engaged in the business of offering and selling fractionalized interests in life insurance policies, an investment product they call "bonded life settlements" or "bonded senior settlements." (Eme Decl. Exh. 1 at 6-8, Exh. 2 at 8-9, 16-20, 64; Exh. 25, Exh. 36.) Defendants represent to investors that they will receive returns on these investments as high as 125%, and have sold fractional interests in over 40 policies to over 500 hundred investors in at least 20 states including California, Florida, and Texas. (Eme Decl. Par. 26; Eme Decl. Exh. 41.)

The investors have paid a combined total of at least $25 million for their investments and ostensibly should receive a combined return of at least $55 million. (Eme Decl. Par. 26.) Some investors have invested hundreds of thousands of dollars, and some have invested in multiple policies offered over a period of months or years. (Eme Decl. Exh. 7 at 7-8, Exh. 29.) Investors have been encouraged to place their retirement savings in Defendants' program, and many have done so. (Eme Decl. Exh. 6 at 53, Exh. 7 at 59-60, Exh. 18 at 48-49, Exh. 19, 27-28; Eme Decl. Par. 42.) Many investors are senior citizens. (Eme Decl. Par. 42)

Investors are typically solicited by a network of sales agents used by Defendants. (Eme Decl. Exh. 1 at 8-9, 17-18, Exh. 30.) Defendants and their sales agents communicate with investors and potential investors via mail, telephone, and the Internet. (Eme Decl. Exh. 6 at 17-

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[1] Although this testimony does not directly state that Neuhaus and his wife own Lyndon Group, it appears from the testimony that as with SIS and AFS, they are the owners.

19, 42-44, Exh. 7 at 24-31, Exh. 19, 32, 37, 41.) Investors sign standard purchase agreement documents created and provided by Defendants. (Eme Decl. Exh. 1 at 15, Exh. 3-4.) SIS or one of the other corporate defendants is a party to the purchase agreement. (Eme Decl. Exh. 3-4.)

Defendants obtain the life insurance policies from various policy brokers, paying the brokers a fraction of the policy's face amount. (Eme Decl. Exh. 1 at 7-8, 15.) Upon selling a policy to investors, Defendants record the investors as beneficiaries and owners of the policy on the insurance company's records. (Eme Decl. Exh. 2 at 25-26, Exh. 32, 36, 44.) When the insured on the policy dies, the insurance company should pay each investor a pro rata share of the policy face amount that equals his or her original investment plus the return. (Eme Decl. Exh. 2 at 8-9, 24-27, Exh. 32.)

A life expectancy estimate and a bond purportedly provide investors with a set time by which they will receive their return. For the insured on each policy, Defendants obtain a written life expectancy estimate, which includes information on the insured's age and health status. (Eme Decl. Exh. 1 at 66; Exh. 10, 36.) These estimates typically project that the insured will die in three to six years and, by extension, forecast when investors will receive a return. (Eme Decl. Exh. 10, 36.) Defendants provide copies of the life expectancy estimates to investors, either directly or through sales agents. (Eme Decl. Exh. 1 at 88, Exh. 32, 37.)

Many of the investments have been "bonded." (See Eme Decl. Exh. 2 at 26-27; Segner Declaration Par. 24.) The bond is purportedly structured so that if the insured lives beyond the life expectancy, then, after a waiting period, the investors assign their ownership in the policy to the bonding company, which then pays the investors the amount they would otherwise receive from the insurance company upon the death of the insured. (Eme Decl. Exh. 2 at 25-26, Exh. 3-4, Exh. 36.) Defendants provide copies of the bonds to investors either directly or through sales agents. (Eme Decl. Exh. 32, 37.)

Once a policy is sold to investors, premiums on the policy must be paid to prevent it from lapsing, (Eme Decl. Exh. 2 at 26-27), after which the insurance company will not pay policy benefits, (Goldsholle Declaration Par. 14.) The purchase agreements typically state that included in what investors pay for the investment is an amount sufficient to pay policy premiums for the

life expectancy of the insured plus the typical bond waiting period (12 months), and that Defendants will use this amount to pay the premiums. (Eme Decl. Exh. 3-4.)

Defendants manage the pools of fractional policy interests. As they are raising funds from investors, Defendants locate, negotiate for, and acquire a life insurance policy from a policy broker. (Eme Decl. Exh. 1 at 7-10, 81, Exh. 2 at 11, 94, 110, Exh. 3-4, 41, 43.) They are responsible for ensuring that the policy is not oversold or undersold to investors. (Eme Decl. Exh. 2 at 11.) They unilaterally choose the bonding company for the policy and pay for the bond. (Eme Decl. Exh. 1 at 11-12, 32, 48, 54-55, 81, Exh. 2 at 27-29, 30, 34, 36-40, 61, 110.)

After a particular policy is completely sold to investors, Defendants contact the insurance company to have the investors recorded as owners and beneficiaries on the policy. (Eme Decl. Exh. 1 at 81, Exh. 2 at 110, Exh. 3-4, 32, 44.) Defendants also control whether to make any policy premium payment, or instead pay other business expenses, and whether to cover premiums with cash or with cash value that has accumulated in the policy.[2] (Eme Decl. Exh. 1 at 8, 13-16, 81, Exh. 2 at 11-12, 60-62, 75-77, 110, Exh. 16.) Defendants monitor the health and status of the insured and file any claim for policy benefits (with assistance from a firm Defendants retain). (Eme Decl. Exh. 2 at 12-13, Exh. 42.) Finally, Defendants submit and pursue any claim against the bonding company. (Eme Decl. 2 at 27, Exh. 25.) The investors are therefore passive participants in Defendants' scheme, with their role limited to signing purchase documents and paying for the investment. (Eme Decl. Exh. 1 at 80-81, Exh. 2 at 109-110; Exh. 6 at 13-15.)

During the period of approximately 2001 through April 2005, Neuhaus and Snowden operated the scheme primarily through AFS. (Eme Decl. Exh. 2 at 16, Exh. 25, Exh. 40.) During this period, they sold fractional interests in at least 27 policies to investors for approximately $12 million in investor proceeds. (Eme Decl. Par. 34.) In April 2005, the Internal Revenue Service executed search warrants at AFS's office and Neuhaus's home. (Eme Decl.

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[2] "Cash value" refers to funds that can accumulate within a policy and are held by the insurance company. Cash value is an asset that belongs to the owners of the policy, and generally can be loaned to the owner or used to pay premiums in lieu of cash payments. (Goldsholle Decl. Par. 16-19.)

Exh. 1 at 40, 77, Exh. 2 at 107; see Eme Decl. Par. 8.) Soon after the search, Neuhaus and Snowden stopped using AFS as the primary vehicle for the scheme and closed its bank accounts. (Eme Decl. Exh. 1 at 84, Exh. 34.) They continued the scheme through the newly created SIS, which opened new accounts at a different bank. (Eme Decl. Exh. 1 at 84, Exh. 34.)

Since approximately May 2005, Neuhaus and Snowden have sold fractional policy interests primarily through SIS. (Eme Decl. Exh. 2 at 11, 16, 20, Exh. 40.) Lyndon Group was also involved in the scheme during approximately 2005-2006. (Eme Decl. Exh. 1 at 24-25, Exh. 2 at 20, Exh. 34.) Since approximately May 2005, SIS and Lyndon Group have sold fractional interests in approximately 15 policies and raised approximately $13 million from investors. (Eme Decl. Par. 34.) Defendants have never filed a registration statement with the Commission covering the offers and sales of their investments. (Eme Decl. Exh. 1 at 80; Eme Decl. Par. 46.)

B. Defendants' Ponzi Scheme Is On The Verge Of Collapse

Contrary to their representations to investors, Defendants do not reserve investor funds to pay future policy premiums, and instead rely on raising money from new investors to pay premiums on previously sold policies. Consequently, the scheme is in danger of collapsing.

Neuhaus and Snowden acknowledge that when a policy is sold to investors, the corporate defendants should set aside a portion of investor funds sufficient to pay future premiums on the policy for the period of the life expectancy plus the bond waiting period. (Eme Decl. Exh. 1 at 8, 12-13, Exh. 2 at 89-91.) In this vein, Defendants' purchase agreements typically contain the following representations:

- "All of the following costs associated with the purchase of an interest of [sic] a policy are included in the investment amount . . . A premium payment for a minimum of one year beyond the projected life expectancy of the insured, or until the policy is purchased by the bonding company, whichever comes first.";
- "SIS may escrow funds for future premium payments for a minimum of twelve (12) months beyond the projected life expectancy of the insured, or longer at SIS's discretion . . ."; and

- "Future premiums, for a minimum of the life expectancy of the insured plus twelve (12) months, or longer at the SIS's discretion, shall be paid by SIS . . ."

(Eme Decl. Exh. 3-4.) Other written materials that Defendants or their sales agents distribute to investors similarly represent that Defendants will "set aside" or "escrow" investor money to cover future premiums. (Eme Decl. Exh. 5, 27, 28, 32.)

Defendants thereby represent to investors that a portion of their investment money will be used to finance future premiums, that Defendants will reserve that portion to pay the premiums, and that Defendants will use the reserve to pay the premiums. These representations are false. Future premium payments are "not included in the investment amount" because Defendants do not "escrow," "set aside," or otherwise reserve investor funds for payment of future premiums. Rather, as Snowden stated in her investigative testimony, Defendants commingle investor funds immediately upon receiving them and use them to pay premiums on any policy they previously sold, to purchase policies, to pay sales commissions, and to cover any other expense of the scheme. (Eme Decl. Exh. 2 at 62, 91-98, 101-02, 110-111, 114-115.) Defendants have been operating in this fashion since at least June 2005. (Segner Decl. Par. 6, 18-24)

For example, SIS raised approximately $2 million from investors in the Perillo policy during the period of August 2005 to June 2006. (Segner Decl. Par. 21.) These funds were spent in part to pay premiums on other policies. Id. Starting in late 2006, SIS also raised about $1.7 million from investors in the Altrogge policy, and these funds were spent in part to pay premiums on other policies. (Segner Decl. Par. 22; Eme Decl. Exh. 2 at 91.) Defendants have also used new investor money to make refunds to previous investors. (Segner Decl. Par. 19-20.)

Because of such practices, Defendants currently lack sufficient funds to pay future premiums on previously sold policies, meaning those premiums can be "paid by SIS" only if Defendants raise new money from new investors in new policies. Indeed, as of June 30, 2007, the corporate defendants were obligated to pay at least $3.1 million in premiums on policies they had already sold if the insureds live until the end of the bond waiting period. (Segner Decl. Par. 24.) In addition, as detailed below, Defendants owed $1 million in "self-insurance" to investors in two policies as of mid-June. As of June 30, Defendants had approximately $160,000 in

corporate bank accounts. (Eme Decl. Par. 31; Segner Decl. Par. 24) If premiums go unpaid policies will lapse, the insurance companies will not pay benefits, and investors will lose their entire investments. (Segner Decl. Par. 8; Goldsholle Decl. Par. 14.)

Snowden is well aware of the cash crisis because she keeps SIS's books and financial statements, she has control over SIS's bank accounts, and she writes the checks to pay policy premiums. (Eme Decl. Exh. 2 at 10-12, 58-64, 70-72.) Likewise, Neuhaus is familiar with the flow of funds through the investment program; he monitors corporate bank account balances and activity; he participates in managing business expenses; and he knows that SIS is frequently short of cash needed to pay policy premiums. (Eme Decl. Exh. 1 at 10-13, 25-31, 58-59, 63-64, 82-84, Exh. 2 at 75, 99.) Lacking cash, Defendants have at times used cash value accumulated in the policies to cover premiums. (Eme Decl. Exh. 1 at 8, 30, Exh. 2 at 76-77, 79.) Cash value is an asset owned by the investors, (Goldsholle Decl. Par. 19.), yet Defendants have not obtained the investors' authorization to deplete cash value to cover premiums, (Eme Decl. Exh. 6 at 24).

While operating the scheme, Neuhaus and Snowden have enriched themselves with investor money. From June 2005 through June 2007, Neuhaus received approximately $500,000 from SIS bank accounts. (Segner Decl. Par. 13.) Snowden received approximately $240,000 from the bank accounts during this period. Id. Because SIS's and the other corporate defendants' only source of income is investor money, (Eme Decl. Exh. 1 at 63, Exh. 2 at 107), the money that Neuhaus and Snowden took came from investors.

C. Defendants Cannot Fulfill Their "Self-insurance" Representations

In September 2003, AFS purported to provide the bond or "self-insurance" for two policies that would pay investors a combined return of $1 million. (Eme Decl. Exh. 1 at 58, Exh. 11.) Defendants did not, however, set aside or segregate funds needed to perform on the "self-insurance" if necessary, and the corporate defendants lack the funds to perform. (Eme Decl. Exh. 1 at Tr. 58-59.)

On June 11, 2007, Neuhaus wrote investors in the policies informing them that "the maturity date of your investment . . . has arrived." (Eme Decl. Exh. 12.) This letter further stated that once investors submit paperwork assigning over their policy ownership, "the

appropriate checks will be issued to each of the investors according to their respective percentage of ownership." Id. As Defendants know, they can obtain the $1 million needed to cover such checks only from investors in other policies, and any investors who give up their ownership in the self-insured policies may not receive a full return.

D. Defendants' Life Expectancy Estimates are Falsely Certified and Unreliable

In the purchase agreements, Defendants represent to investors: "All life expectancies of insured [sic] will be determined by an independent reviewing physician taking into account the insured's age, current medical history, and, where applicable, insurance industry actuarial guidelines." (Eme Decl. Exh. 3-4.) Most of the life expectancies Defendants have provided to investors are in the form of written "certificates" bearing the name of AmScot Medical Labs, Inc. ("AmScot") or Midwest Medical Review LLC ("Midwest"). (Eme Decl. 1 at 66, Exh. 2 at 68-69, Exh. 10.) Many of the certificates under the AmScot name bear the name "George Kindness, M.D." and bear his signature. (Eme Decl. Exh. 1 at 66-67, Exh. 10.)

Contrary to the purchase agreement and the certificates, Kindness is not an M.D. or physician. (Eme Decl. Exh. 31.) Furthermore, in November 2003 a federal grand jury indicted Kindness along with AmScot on twenty-one counts involving conspiracy and fraud in the introduction of misbranded and adulterated drugs into commerce. (Eme Decl. Exh. 8.) The indictment includes an allegation that Kindness falsely represented himself as an M.D. (Eme Decl. Exh. 8.) In July 2005, both Kindness and AmScot pled guilty to one count of the indictment, and in September 2006 both were convicted and sentenced. (Eme Decl. Exh. 9.)

Neuhaus and Snowden are on notice of these facts. In September 2005, Neuhaus received a letter from a concerned investor stating the Kindness was not an M.D. and enclosing a copy (unofficial) of the indictment. (Eme Decl. Exh. 49.) In investigative testimony, Snowden indicated that as of approximately mid-2005, she became aware that Kindness had, as she put it, "legal problems," and she now knows he has been convicted of a crime. (Eme Decl. Exh. 2 at 115-117, 121.)

Although operating under a different name, Midwest is controlled by Kindness and a continuation of AmScot's operation. After Kindness was indicted, the certificates Defendants

provided to investors switched from bearing the AmScot name to bearing the bearing Midwest name. (Eme Decl. Exh. 10.) Kindness was president, director, and part-owner of AmScot; he is the sole member of the Midwest LLC; and although he has not signed recent certificates, he still provides input in Midwest's operations. (Eme Decl. Exh. 9, 31.) The continuity of operations from AmScot to Midwest was obvious to Defendants from the face of the certificates from the two entities. Some have a facsimile header line that reads "Midwest Amscot." There are certificates under each entity's name with similar typefaces and format, the names of the same purported physicians, and the same facsimile number. (Eme Decl. Exh. 10.) Snowden acknowledged such similarities in her investigative testimony. (Eme Decl. Exh. 2 at 121.)

Defendants have not disclosed the negative facts about Kindness and AmScot-Midwest to investors. (Eme Decl. Exh. 6 at 38-39, Exh. 7 at 36, Exh. 48-49.) Additionally, the life expectancy estimates have a poor record of accuracy. Insureds on over 20 policies sold by Defendants remain alive today beyond the end of the life expectancy estimate, some by two or three years. (Eme Decl. Par. 46.)

E. Defendants Have Failed to Disclose Risks Associated With the Bonds

Defendants have represented to investors that some of their money goes to pay for a bond that will provide a return if the life expectancy estimate proves wrong. Defendants' purchase agreements typically state that that the investment "shall carry an insurance bond" that will pay the investor "the full face value of their interest in the policy, should for any reason, the policy not mature within the limits indicated in the agreement." (Eme Decl. Exh. 3-4.) A policy "matures" when the insured dies. (Eme Decl. Exh. 1 at 31.) The purchase agreements also typically state that "included in the investment amount . . . [is] [t]he Bonding Company fee for the life of the Agreement." (Eme Decl. Exh. 3-4.) Documents that Defendants have provided to investors either directly or through sales agents have stated that "[b]onding the policy protects the investor from greatly reducing the fixed rate of return due to the insured living longer than the estimated life expectancy." (Eme Decl. Exh. 5.) In truth, the bonds do not "protect" investors due to many undisclosed risk factors.

Defendants have used four bonding companies: International Fidelity & Surety Ltd. ("IFS"), purportedly based in the Pacific Island nation of Vanuatu; Provident Capital and Indemnity Ltd. ("Provident"), purportedly based in Costa Rica; BALGI, purportedly based in Brunei; and Sino Reinsurance ("Sino") purportedly based in Australia. (Eme Decl. Exh. 1 at 43-44, 48, Exh. 2 at 27-28, 49, Exh. 13-15, 17, Exh. 45 at 57-58.) IFS has already refused to perform on bonds on over 20 policies sold by Defendants. (Eme Decl. Exh. 25, 38.) IFS and Provident have been the subjects of actions by state regulators in California, Texas, and Florida variously involving unauthorized issuance of insurance and fraud. (Eme Decl. Exh. 20-23.) Two of these actions involved other "life settlement" investment programs. (Eme Decl. Exh. 22-23.)[3] None of the four bonding companies is licensed to provide insurance anywhere in the U.S.[4] These facts create risks that the bonding companies issued the bonds fraudulently or otherwise in violation of law and will not perform on the bonds if necessary. Defendants have not disclosed these risks to investors. (Eme Decl. Exh. 6 at 27-37, Exh. 7 at 39-47, Exh. 48-49.)

Defendants knew or were reckless in not knowing of these risks. Neuhaus stated in investigative testimony that he formerly worked in the insurance industry, and at the time he selected the first bonding company, IFS, he knew it did not possess a license to provide insurance in any state in the U.S. (Eme Decl. Exh. 1 at 32-33, 44, 79.) In the September 2005 letter to Neuhaus described above, the investor expressed concern that IFS was not licensed. (Eme Decl. Exh. 49.) In October 2005, AFS sued IFS for fraud in refusing to perform on bonds. (Eme Decl. Exh. 25.) Neuhaus testified that after IFS's non-performance, he believed he should be especially cautious in choosing other bonding companies. (Eme Decl. Exh. 1 at 51-52.) Yet the companies he and Snowden chose were unlicensed and had adverse regulatory histories.

In approximately February 2007, Sino purportedly became responsible for performing on the BALGI bonds. (Eme Decl. Exh. 2 at 49-51, Exh. 45 at 56-57, 60-62.) According to their

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[3] In addition, IFS provided bonds in a "life settlement" case brought by the Commission in late 2006. (Eme Decl. Exh. 46)

[4] Witnesses testified that IFS, BALGI, and Sino are not licensed. (Eme Decl. Exh. 1 at 44, Exh. 45 at 119, 125) The Commission staff surveyed websites of state insurance regulators and found no indication that Provident is licensed anywhere in the U.S.

testimony, Neuhaus and Snowden have no understanding of how this arrangement works and have made no attempt to determine if Sino is a legitimate insurer with the ability to perform if necessary. (Eme Decl. Exh. 1 at 54, Exh. 2 at 49-52.) Defendants have taken no steps to inform investors covered by the BALGI bonds that Sino is purportedly now responsible for them. (Eme Decl. Exh. 2 at 51.) As for BALGI, its website has been "under construction" with no substantive content since at least March 2007. (Eme Decl. Exh. 24.)

F. Defendants Have Concealed Their Own Adverse Regulatory History

In February 2003, the California Department of Corporations ordered Neuhaus and AFS to cease selling investments of the type involved here. (Eme Decl. Exh. 26.) The order found that in selling the investments, Neuhaus and AFS made material misstatements and omissions of fact involving the bond, the return, liquidity, and licensing status. Id. Defendants have not disclosed the order to investors. (Eme Decl. Exh. 6 at 39-41, Exh. 7 at 48-51, Exh. 48.)

G. Sales Agents Under Defendants' Control Have Misrepresented the Investment

Promotional materials distributed by sales agents to investors have made the following claims: (i) an independent escrow company "handles all the money transactions" including paying policy premiums; (ii) policy premiums will be paid because "[SIS] will have collected enough money to support the term of the investment plus an extra year"; (iii) the bonding company agrees to bond the investment on the basis of "a consensus of three medical opinions"; and (iv) the investment is "guaranteed" and has "little, if no, risk." (Eme Decl. Exh. 27-28, 33.) As shown above, these claims are false and misleading.

Many sales agents operate under written agreements with SIS. (Eme Decl. Exh. 30.) The agreements require the agents to obtain approval from SIS before using written promotional materials. Id. If Neuhaus and Snowden exercised this contractual oversight, they are aware of the misrepresentations in the sales agent materials. If they did not exercise the oversight, then they recklessly allowed their sales agents to misrepresent the investment.

H. The Fraud is Ongoing

Defendants have consumed significant investor funds in recent months. During the period of April-July 2007, SIS bank accounts received approximately $1.8 million. (Eme Decl. Par. 31.) At the end of July, the bank accounts held just $63,000. (Eme Decl. Par. 31) Just weeks ago, a sales agent website offering the investments touted Provident and IFS as bonding companies and called the investment "SAFE," with an escrow company "handl[ing] all distributions." (Eme Decl. Exh. 19.)

In early July, the Florida Office of Financial Regulation obtained a temporary restraining order against SIS prohibiting it from further sales of unregistered securities in Florida. (Eme Decl. Exh. 39.) The order required SIS to provide an accounting by late July, and to date SIS has not done so. (Moore Declaration Par. 8.)

In late July, Snowden transferred $250,000 from an SIS bank account to a law firm representing AFS, and the law firm apparently began making partial payments to investors in the two self-insured policies who have given up their policy ownership as Neuhaus requested in his June letter. (Eme Decl. Exh. 12.) This $250,000 came from money that SIS had been holding in an escrow account for the purchase of the Altrogge policy. (Baer Declaration Par. 5-11.) Therefore, Defendants are using funds from the Altrogge policy investors to pay off investors in two policies they sold years ago. A letter from the law firm accompanying a partial payment maintains that Neuhaus is in the process of "selling an investment that is stuck in escrow," and will later be able to pay investors in full. (Eme Decl. Exh. 12) Thus, Neuhaus has enticed investors in the self-insured policies to give up their policy ownership with an unreliable assurance that they will get their full return.

In early August, counsel for AFS wrote to investors in policies bonded by IFS to announce that AFS would no longer pay premiums on those policies. (Eme Decl. Exh. 52.) The letter suggested that AFS had been using "reserves" to pay the premiums on the policies and that the "reserves" were now exhausted. In fact, SIS has been paying premiums on old policies with new investor money for over two years, and neither it nor AFS had any bona fide premium "reserves" during that time. (Segner Decl. Par. 6, 18-24) The letter gives investors two

undesirable choices: keep paying policy premiums on their own until the insured dies, or resell the policies for whatever they can get.

III. Argument

A. The Court Should Issue a Temporary Restraining Order Enjoining Defendants From Violating the Antifraud and Registration Provisions of the Federal Securities Laws.

Under Section 20(b) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77t(b), and Section 21(d) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78u(d), the Commission may obtain emergency injunctive relief upon a "proper showing" that defendants have violated the federal securities laws. Injunctive relief is appropriate when the plaintiff establishes either (1) a likelihood of success on the merits and the possibility of irreparable injury, or (2) that serious questions going to the merits are raised and the balance of hardships tips sharply in its favor. Walczak v. EPL Prolong, Inc., 198 F.3d 725, 731 (9th Cir. 1999). Because the Commission is bringing this action pursuant to its statutory mandate to safeguard the public interest and to enforce the federal securities laws, irreparable injury may be presumed. See United States v. Odessa Union Warehouse Co-Op, 833 F.2d 172, 174-75 (9th Cir. 1987) (holding irreparable injury presumed in federal agency action for injunctive relief); Navel Orange Admin. Comm. v. Exeter Orange Co., Inc., 722 F.2d 449, 453 (9th Cir. 1983) (same). A more lenient standard applies to the Commission's request for injunctive relief because the agency appears "not as an ordinary litigant, but as a statutory guardian charged with safeguarding the public interest." SEC v. Management Dynamics, Inc., 515 F.2d 801, 808 (2d Cir. 1975).

Here, the Commission has established a strong likelihood of success on the merits of its claims that Defendants have violated the federal securities laws. Defendants are likely to continue such violations, putting old and new investor funds at risk, unless they are enjoined from doing so, making a temporary restraining order and preliminary injunction necessary.

1. The Investments Constitute Securities

As a threshold matter, the investments Defendants sell are "securities," and therefore within the ambit of the federal securities laws. Section 2(a)(1) of the Securities Act, 15 U.S.C §

77b, and Section 3(a)(10) of the Exchange Act, 15 U.S.C § 78c, define a security to include an "investment contract." Under Supreme Court precedent known as the Howey test, an investment contract is a security if it is a contract, transaction or scheme involving (1) an investment of money, (2) in a common enterprise, (3) with the expectation of profits to be derived from the efforts of others. SEC v. W.J. Howey Co., 328 U.S. 293 (1946). In applying the Howey test, the Ninth Circuit has stated that Congress "defined 'security' sufficiently broadly to encompass virtually any instrument that might be sold as an investment." SEC v. Rubera, 350 F.3d 1084, 1090 (9th Cir. 2003).

a. Investment of Money

The first element, an "investment of money," is met when an investor "commit[s] his assets to the enterprise in such a manner as to subject himself to financial loss." Hector v. Wiens, 533 F.2d 429, 432 (9th Cir. 1976). Here, more than 500 investors have invested at least $25 million on the expectation of receiving returns exceeding 100 percent. By entrusting their funds to Defendants, investors subjected themselves to loss through a number of risks, including that insureds may outlive life expectancy estimates, that bonding companies may fail to perform, and that funds to pay premiums may be exhausted causing policies to lapse.

b. Common Enterprise

The Ninth Circuit has held that the "common enterprise" element is met with either horizontal or vertical commonality. See SEC v. R.G. Reynolds, 952 F.2d 1125, 1134 (9th Cir. 1991). Horizontal commonality exists when fortunes of each investor are linked and investor funds are pooled. See Curran v. Merrill Lynch, Pierce, Fenner, & Smith, Inc., 622 F.2d 216 (6th Cir. 1980), aff'd., 456 US 353 (1982). Vertical commonality refers to the relationship between the investor and investment promoter, and exists when the fortunes of the investors are tied to the fortunes of the promoters. SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 482 n.7 (9th Cir. 1972), cert. denied, 414 U.S. 821 (1973). A common enterprise exists under the vertical commonality where investors' avoidance of loss depends on the promoter's "sound management and continued solvency." United States v. Carman, 577 F.2d 556, 563 (9th Cir.1978).

Defendants' scheme is a common enterprise with both horizontal and vertical commonality. Horizontal commonality exists because Defendants pool funds from numerous investors in common accounts used for the purchase of the life insurance policies, payment of premiums, and other expenses, and investors' profits rise or fall together. Vertical commonality exists because the profits and risk of loss are dependent on Defendants' ability to locate and acquire suitable policies, make continued premium payments, monitor the insureds, and file claims with insurance companies and bonding companies.

c. Efforts of Others

The final Howey element requires that expected investment profits derive "from the efforts of others." This element is met where the efforts of the promoters or other parties are undeniably significant ones, or essential managerial efforts that affect the failure or success of the enterprise. See Turner, 474 F.2d at 482.

Defendants perform essential managerial functions here. They locate, negotiate for, and acquire the life insurance policy from the broker and ensure that the policy is not oversold or undersold to investors. They choose the bonding company for the policy and pay for the bond. They manage payment of policy premiums, deciding whether to pay premiums when due or instead pay other business expenses and whether to cover premiums with cash or policy cash value. Defendants (and a firm they retain) monitor the status of the insured and file any claim for policy benefits with the insurance company. Finally, Defendants submit and pursue any claim against the bonding company. These activities require knowledge, skill, and discretion on which passive investors rely to ensure the profitability and safety of the investment.

The Eleventh Circuit recently held that a similar scheme of selling fractionalized interests in life insurance policies as "viatical settlements" involved securities. SEC v. Mutual Benefits Corp., 408 F.3d 737, 745 (2005). In that case, investors relied on defendant Mutual Benefits to identify polices for purchase, negotiate a purchase prices for those policies, and obtain life expectancy estimates. As with investors in the case at hand, Mutual Benefits investors were passive and relied on the promoters to pay policy premiums and manage the investment. Id. at 738, 744-45.

Even under a more stringent standard used in one case by the D.C. Circuit, under which there must be "post-purchase" efforts of others that are "entrepreneurial" rather than "ministerial," the investments here are securities. See SEC v. Life Partners, Inc., 87 F.3d 536, 314 (D.C. Cir. 1996).[5] After investors have begun paying for investment purchases, Defendants locate, negotiate for, and acquire the policy; ensure that the policy is not oversold or undersold; and choose the bonding company and pay for the bond. After the policy is completely sold to investors, Defendants manage payment of policy premiums, monitor the insured's status, make any claim for policy benefits, and pursue any claim against the bonding company.

2. Defendants Are in Violation of Antifraud Provisions

Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), prohibits fraud in the offer or sale of securities. Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5, prohibit fraud in connection with the purchase or sale of securities. These antifraud provisions prohibit conduct including making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. To violate the antifraud provisions, a misstatement or omission must concern a material fact. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32, 99 L. Ed. 2d 194, 208-09 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449, 48 L. Ed. 2d 757, 766 (1976)). A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. TSC Indus., 426 U.S. at 449, 48 L. Ed. 2d at 766. Scienter is required to establish a violation of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Exchange Act Rule 10b-5. Aaron v. SEC, 446 U.S. 680, 695, 64 L. Ed. 2d 611, 625 (1980). Scienter is the mental state of intending to deceive, manipulate, or defraud. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976). In the Ninth Circuit, reckless conduct satisfies the scienter requirement. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990) (en banc).

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[5] The Eleventh Circuit declined to adopt the Life Partners standard, rejecting the distinction between pre-purchase and post-purchase activities unsupported by statutes or policy. Mutual Benefits, 408 F.3d at 743.

Defendants have violated the antifraud provisions. They represented to investors that a portion of their investment money funded future premiums, that Defendants would reserve that portion to pay the premiums, and that Defendants would use that portion to pay the premiums. In reality, Defendants have not reserved the necessary funds and are operating a ponzi scheme where they must raise money from new victims to cover premiums on previously sold policies. Defendants represented to investors that life expectancy estimates were prepared by a physician, yet Kindness is not a physician, and Defendants failed to disclose that he and AmScot-Midwest have a criminal history involving fraud and false statements. Defendants told investors that the bonds "protect" the investment and will pay the return even if the insured outlives the life expectancy, but failed to disclose that the bonding companies are unlicensed and have adverse regulatory histories. Defendants also failed to disclose their lack of funds to perform on their "self-insurance" and their own negative regulatory history. Sales agents under Defendants control misrepresented and omitted key facts.

These false statements and omissions were clearly material. Investors have provided statements that the undisclosed facts about the ponzi scheme, the life expectancies, the bonding companies, and the California order would have been crucial in their investment decision had they known about them. (Eme Decl. Exh. 6 at 24-41, 44-45, 48-51, 53-54, Exh. 7 at 36-37, 39-52, 54-58, Exh. 48, 49.) Courts have deemed material the type of information that Defendants withheld regarding uses and commingling of investor funds and the need to raise new funds to support old investments. See SEC v. Murphy, 626 F.2d 633, 653 (9th Cir. 1980); Koehler v. Pulvers, 614 F. Supp. 829, 842 (S.D. Cal. 1985). Likewise, courts view a state order to stop selling similar investments as material. See SEC v. Merchant Capital LLC, 483 F.3d 747, 771-72 (11th Cir. 2007).

Defendants acted with scienter. Neuhaus and Snowden control the corporate defendants and acknowledge that they should have reserved funds to pay for future premiums.[6] Neuhaus

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[6] Because of their control positions, the mental state of Neuhaus and Snowden is imputed to the corporate defendants. See SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1096 n.16 (2d Cir. 1972).

and Snowden's investigative testimony demonstrates that they are knowingly operating a ponzi scheme. Snowden testified that she writes the checks to pay policy premiums. (Eme Decl. Exh. 2 at 11-12, 74.) When asked if SIS had enough money to pay policy premiums in the next three or six months, Snowden stated that she did not know. Id. at 77-78. She further stated that Neuhaus is responsible for determining how SIS will meet premium obligations. Id. at 74. Neuhaus later testified, however, that Snowden monitored available cash and would know if there was sufficient money to cover the premiums. (Eme Decl. Exh. 1 at 12, 16-17.)

Neuhaus acknowledged that SIS is frequently short of cash needed to pay policy premiums and meet other obligations. Id. at 10-12, 25-31, 58-59. Snowden testified that SIS "possibly" will have to raise new money to meet premium obligations. (Eme Decl. Exh. 2 at 78-79.) She further testified that SIS recently used money from investors in the Altrogge policy to pay premiums on another policy. Id. at 91. When Neuhaus was asked if AFS has funds to perform on its self-insurance, he answered, "We have no money in the bank for that policy today, but tomorrow maybe we will." (Eme Decl. Exh. 1 at 58-59.)[7]

Both Neuhaus and Snowden refused to answer certain questions on the basis of the Fifth Amendment to the U.S. Constitution. Snowden asserted the Fifth Amendment privilege when asked if she believed it was appropriate for SIS to use money from new investors to pay premiums on previously sold policies without disclosing this to the new investors. (Eme Decl. Exh. 2 at 81-84, 91-92.) Neuhaus asserted the privilege when asked if he believed investors should be told that money to pay future premiums on their policy might need to be raised from other sources. (Eme Decl. Exh. 1 at 31-32.) Given Neuhaus's and Snowden's refusal to answer questions on Fifth Amendment grounds, the Court should infer their liability. See SEC v. Colello, 139 F.3d 674, 677 (9th Cir. 1998) (in a civil proceeding a trier is permitted to draw a negative inference from a party's invocation of the Fifth Amendment).

[7] Although one self-insured policy was referenced in the testimony, there are two such policies. (Eme Decl. Exh. 11.)

3. Defendants are in Violation of Registration Provisions

Section 5 of the Securities Act, 15 U.S.C. § 77(e), prohibits any person, directly or indirectly, from using instrumentalities of interstate commerce or the mails to offer or sell a security unless a registration statement is in effect as to such security. In order to establish a prima facie case for violation of Section 5, the Commission must show that (1) securities were offered or sold for which no registration statement was in effect; (2) the offering or sale was made through the means or instruments of transportation or communication in interstate commerce or the mails; and (3) defendants, directly or indirectly, offered or sold the securities. See SEC v. Continental Tobacco Co., 463 F.2d 137, 155 (5th Cir. 1972); SEC v. Murphy, 626 F.2d 633, 639 (9th Cir. 1980). Scienter is not an element of a Section 5 violation. See Aaron v. SEC, 446 U.S. 680, 712, 64 L. Ed. 2d 611, 636 (1980).

Defendants and their sales agents offered and sold securities for which no registration statement was in effect. Defendants and the sales agents communicated with investors and potential investors via mail, telephone, and over the Internet, thereby using the means of interstate commerce. A prima facie case thus exists that defendants violated the registration provisions of the federal securities laws.

4. Investor Funds are at Risk Without Injunctive Relief

Although the Commission need not show irreparable injury to obtain injunctive relief, investors are in immediate danger of permanently losing their investments. New investors are in danger because Defendants are spending new money as they receive it instead of setting it aside to pay future premiums. All investors are in danger because if Defendants cannot pay policy premiums, policies will lapse and investors will lose their entire investment. Defendants must be restrained and enjoined to protect against permanent loss of investor funds.

B. Other Emergency Relief is Necessary and Appropriate

1. Asset Freeze

An asset freeze is necessary to protect investor funds. This Court has the inherent equitable authority to issue ancillary relief in Commission injunctive actions, SEC v. Wencke, 622 F.2d 1363, 1369 (9th Cir. 1980), including the freezing of assets, SEC v. International Swiss

Invs. Corp., 895 F.2d 1272, 1276 (9th Cir. 1990). Courts have ordered asset freezes to prevent dissipation of assets and to ensure their availability for restitution and disgorgement. See, e.g., FTC v. H.N. Singer, Inc., 668 F.2d 1107, 1112-13 (9th Cir. 1982). As long as the Commission is likely to succeed on the merits, the mere possibility of dissipation of assets is sufficient to warrant an asset freeze; a likelihood of dissipation need not be shown. FSLIC v. Sahni, 868 F.2d 1096, 1097 (9th Cir. 1989). Neuhaus and Snowden have taken considerable investor funds for themselves, and an asset freeze is necessary to protect investor money.

2. Accounting

The Commission also requests that the Court order the Defendants to submit a verified accounting for the purpose of identifying the location and disposition of investor funds and Defendants' assets. This accounting will assist in determining the scope of the fraudulent scheme and preserving investor assets. District courts have ordered accountings on similar facts. See, e.g., International Swiss, 895 F.2d at 1274; Singer, 668 F.2d at 1114.

3. Expedited Discovery

The Commission asks the Court to promptly hold a hearing on the request for a preliminary injunction. To prepare for the hearing, the Commission seeks the ability to take immediate discovery, including depositions and document discovery, from the Defendants and others to obtain additional facts related to the fraud. Accordingly, the Commission requests that the Court permit discovery before the parties have conferred in accordance with Rule 26(f) of the Federal Rules of Civil Procedure.

4. Preservation of Documents

To ensure effective discovery, the Commission seeks an order preventing the alteration or destruction of documents. The requested order is appropriate to protect the integrity of this litigation. See SEC v. Chemical Trust, 2000 WL 33231600 at * 13, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,291, at 95,642 (S.D. Fl. Dec. 19, 2000).

5. Appointment of a Receiver

The Commission asks that the Court appoint a receiver over the corporate defendants to marshal and preserve investor assets. The Ninth Circuit has noted the merits of appointing a

receiver for the purposes of (1) marshalling and preserving assets; (2) acting for the benefit of innocent investors; and (3) conducting an independent inquiry concerning the sources and uses of the funds obtained through a fraud. See Wencke, 622 F.2d at 1372. Appointing a receiver is appropriate when there is a showing of fraud. See SEC v. Keller Corp., 323 F.2d 397, 403 (7th Cir. 1963) ("[I]t is hardly conceivable that the trial court could have permitted those who were enjoined from fraudulent misconduct to continue to control ... for the benefit of those shown to have been defrauded.") District courts in actions involving similar schemes have appointed receivers. See, e.g., Mutual Benefits, 408 F.3d at 741 (noting that the district court appointed a receiver).

A receiver here would step into the shoes of the corporate defendants to marshal and manage corporate and investor assets in the best interests of investors. Defendants have a history of misappropriating and mismanaging investor assets and should not remain in control of bank accounts, policies, and other assets involved in the scheme.

IV. Conclusion

Defendants are operating an egregious fraud that puts millions in investor money at great risk. The Commission respectfully requests that the Court grant the requested relief immediately to protect present and potential victims of this fraudulent scheme.

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Respectfully submitted,

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