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UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA

SECURITIES AND EXCHANGE
COMMISSION,

Plaintiff,

vs.

CAPSOURCE, INC.,
STEPHEN J. BYRNE, and
GREGORY P. HERLEAN
Defendants.

Case No. 20-cv-2303

COMPLAINT

JURY TRIAL DEMANDED

Plaintiff, the United States Securities and Exchange Commission (“SEC”),
alleges as follows:

JURISDICTION AND VENUE

1. The Court has jurisdiction over this action pursuant to Sections 20(b), 20(d)(1), and 22(a) of the Securities Act [15 U.S.C. §§ 77t(b), 77t(d)(1), and 77v(a)], and Sections 21(d)(1), 21(d)(3)(A), 21(e), and 27(a) of the Exchange Act [15 U.S.C. §§ 78u(d)(1), 78u(d)(3)(A), 78u(e), and 78aa(a)].

2. Defendants have, directly or indirectly, made use of the means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national

1 securities exchange in connection with the transactions, acts, practices, and courses of
2 business alleged in this complaint.

3 3. Venue is proper in this district pursuant to Section 22(a) of the Securities
4 Act [15 U.S.C. § 77v(a)], and Section 27(a) of the Exchange Act [15 U.S.C. §
5 78aa(a)], because certain of the transactions, acts, practices, and courses of business
6 constituting violations of the federal securities laws occurred within this district.
7 Moreover, each of the Defendants resides in this district.

8 **SUMMARY**

9 4. This matter concerns multiple fraudulent and unregistered securities
10 offerings conducted by Las Vegas-based hard money lender CapSource, Inc.
11 (“CapSource”) and its principals, Stephen J. Byrne and Gregory P. Herlean
12 (collectively, “Defendants”).

13 5. From approximately January 2015 through May 2019 (the “Relevant
14 Period”), CapSource offered and sold over \$151 million of securities through
15 unregistered offerings to finance projects of various real estate developers.

16 6. As part of these offerings, Defendants helped raise over \$28 million for
17 CapSource’s largest client, an Arizona-based real estate developer (“Individual 1”),
18 and certain entities related to his drug rehabilitation business (“Company A”).

19 7. By approximately May 2017, Company A had experienced significant
20 financial difficulties and cost overruns at its primary treatment facility that depleted
21 most of its cash reserves.

22 8. To keep Company A’s primary treatment facility afloat, the Defendants
23 knew, or were reckless in not knowing, that Individual 1 was diverting millions of
24 dollars of proceeds raised through CapSource for various other projects managed by
25 Individual 1 (some wholly unrelated to Company A), and, contrary to the
26 representations made to the investors in those projects, used them to cover expenses
27 associated with Company A’s primary treatment facility.

28 9. The Defendants furthered their fraud by assisting Individual 1 in raising

1 millions of dollars in subsequent offerings in an attempt to shore up Company A’s
2 finances and replace the shortfalls other projects incurred due to the previous
3 diversion of investor funds. In raising these additional funds, Defendants and
4 Individual 1 failed to disclose their intended use of the new offering proceeds to
5 partially repay, and thereby conceal, the improper diversion of funds that had
6 occurred.

7 10. Currently, investors in the securities offered through CapSource are
8 owed approximately \$47 million of their principal, of which approximately \$18
9 million relates to the offerings associated with Company A.

10 11. As a result of the conduct described herein, Defendants violated and,
11 unless restrained and enjoined, will continue to violate Sections 5(a), 5(c), and 17(a)
12 of the Securities Act of 1933 (the “Securities Act”) [15 U.S.C. §§ 77e(a), 77e(c), and
13 77q(a)] and Sections 10(b) and 15(a) of the Securities Exchange Act of 1934 (the
14 “Exchange Act”) [15 U.S.C. §§ 78j(b) and 78o(a)] and Rule 10b-5 thereunder [17
15 C.F.R. § 240.10b-5].

16 12. The SEC seeks permanent injunctions against each of the Defendants,
17 enjoining each of them from future violations of the securities laws mentioned herein,
18 disgorgement of all their ill-gotten gains from the unlawful activity set forth in this
19 Complaint, together with prejudgment interest, and civil penalties against each of the
20 Defendants under Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section
21 21(d)(3) of the Exchange Act [15 U.S.C. §78u(d)(3)], and such other relief that the
22 Court may deem appropriate.

23 **DEFENDANTS**

24 13. **CapSource, Inc.** is a Nevada corporation with its principal place of
25 business in Las Vegas, Nevada. During the Relevant Period, CapSource was in the
26 business of facilitating real estate-related lending transactions, primarily through the
27 offer and sale of debt securities issued by other borrowing entities. Neither
28 CapSource nor the securities at issue have ever been registered with the SEC in any

1 capacity.

2 14. **Stephen J. Byrne**, age 63, is a resident of Las Vegas, Nevada. Byrne is
3 president, founder, and 40% owner of CapSource. During the Relevant Period,
4 Byrne's principal role at CapSource was to identify and vet potential projects for
5 CapSource to fund through the offer and sale of securities to investors and to perform
6 work-outs of non-performing transactions. Byrne has never held a securities license
7 or been registered with the SEC in any capacity.

8 15. **Gregory P. Herlean**, age 42, is a resident of Henderson, Nevada.
9 Herlean is an executive team member and 30% owner of CapSource. Herlean's
10 principal role at CapSource during the Relevant Period was to find and solicit
11 investors to acquire the securities offered through CapSource and to supervise
12 CapSource's sales staff in that regard. Herlean has never held a securities license or
13 been registered with the SEC in any capacity.

14 **FACTS**

15 **I. Background on CapSource's Business**

16 **A. CapSource's Historical Note Offerings**

17 16. CapSource is a hard money lender whose primary business has been
18 locating investors to pool their funds and collectively invest in real estate-related
19 projects. CapSource accomplished this by offering and selling interests in promissory
20 notes issued by other entities and secured by real estate to hundreds of investors
21 nationwide.

22 17. Each investor in a note funded through CapSource received a fractional
23 share of the note proportionate to his or her investment and was, in turn, granted a
24 secured interest in the underlying real estate in the project equal to his or her
25 fractional interest in the note.

26 18. Typically, the notes were secured by a senior position in the collateral,
27 but, on occasion, CapSource offered interests in notes secured via subordinated
28 positions that paid higher yields.

1 19. CapSource generally paid annual interest rates to investors ranging
2 between six and ten percent, but which could occasionally reach as high as 11 or 12
3 percent.

4 20. CapSource marketed the note interests as “trust deeds,” but also
5 repeatedly referred to them on its website as “investments” and its customers as
6 “investors.”

7 21. CapSource also marketed the note interests on its website as “passive”
8 investments.

9 **B. CapSource’s Role in Assessing the Projects to Be Financed Through**
10 **the Note Offerings**

11 22. The borrowing entities that used CapSource to assist with funding their
12 projects are located throughout the United States and historically have been
13 associated with real estate developers.

14 23. CapSource (specifically Byrne), not the note investors, selected and
15 conducted due diligence relating to the projects and assessed the creditworthiness of
16 potential borrowers.

17 24. CapSource drafted a written summary for each project (the “Loan
18 Summary”) bearing CapSource’s name and signed by the borrower, which described:
19 the terms of the note, including the interest rate and maturity date; the project,
20 including how the note proceeds were to be used; the collateral, including its
21 estimated value relative to the note’s principal amount; and some background on the
22 borrower.

23 25. At the end of the Loan Summary, the principal of the borrowing entity
24 provided a signed certification as to the accuracy of the statements in the Loan
25 Summary and as to his or her creditworthiness.

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1 **C. CapSource’s Role in Locating and Soliciting Investors for the Note**
2 **Offerings**

3 26. CapSource identified prospective new investors through seminars or
4 speaking engagements conducted by Herlean and through leads provided by a
5 network of external finders, who used radio and print advertising, and blast emails,
6 among other marketing tactics.

7 27. Once CapSource identified potential investors, it entered their contact
8 information into a database that formed a call list for CapSource’s internal sales staff.
9 CapSource’s sales staff would call leads and pitch the projects to be financed, which
10 included sending a copy of the respective offering materials (e.g., Loan Summary)
11 approved by Byrne and Herlean.

12 28. Upon closing, CapSource typically received a percentage-based fee
13 (often in the range of five to six percent), which it frequently used to pay
14 commissions to external finders and account executives who located or solicited the
15 investors.

16 **II. Background on CapSource’s Dealings with Individual 1 and Company A**

17 **A. Company A’s Initial Funding Using CapSource**

18 29. Starting around early 2017, CapSource began assisting Individual 1 with
19 financing his drug rehabilitation business, Company A.

20 30. CapSource helped raise \$13 million for Company A by offering and
21 selling interests in a note issued by a subsidiary of Company A to approximately 165
22 investors in multiple states (the “1st Deed Note”).

23 31. Company A used the proceeds from the 1st Deed Note offering to,
24 among other things, acquire and renovate a 207-bed drug rehabilitation facility in
25 Tucson, Arizona (the “Tucson Facility”) and to create reserve accounts to cover its
26 operating costs during the start-up phase.

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1 **B. Byrne and Herlean Knew, or Were Reckless in Not Knowing, that**
2 **Individual 1 Diverted Millions of Dollars to Cover Company A’s**
3 **Losses from Unrelated Projects Funded Through CapSource**

4 32. By approximately May 2017, Company A’s Tucson Facility experienced
5 financial difficulties and cost overruns that depleted its construction and interest
6 reserves.

7 33. In order to continue operating the Tucson Facility, including to make
8 payroll and interest payments to the 1st Deed Note investors, Individual 1 improperly
9 used, with Byrne’s knowledge, investor funds raised by CapSource to fund other
10 projects for Individual 1.

11 34. Byrne knew, or was reckless in not knowing, that Individual 1’s use of
12 funds to cover operating expenses associated with Company A’s Tucson Facility was
13 inconsistent with the Loan Summaries for those other projects.

14 35. For example, on October 19, 2017, Individual 1 sent Byrne and Herlean
15 a schedule showing the cumulative improper transfers from other projects to fund
16 Company A’s Tucson Facility exceeded \$4.3 million.

17 36. By November 2017, the improper transfers grew to over \$4.7 million.
18 Byrne and Herlean knew, or were reckless in not knowing, about these transfers.

19 37. Moreover, by the end of 2017, Company A had incurred nearly \$6
20 million in operating losses. Byrne and Herlean knew, or were reckless in not
21 knowing, about these operating losses.

22 **III. The Fraudulent 2nd Deed Note Offering**

23 38. In an attempt to reverse the improper transfers, Byrne, Herlean, and
24 Individual 1 agreed that CapSource would assist Company A with a new note
25 offering to raise enough funds to repay the other projects. Accordingly, starting
26 around January 2018 and continuing through August 2018, CapSource, on behalf of
27 Individual 1 and a subsidiary of Company A, offered and sold approximately \$5.7
28 million of interests in a note issued by the Company A subsidiary and secured by a

1 subordinate position in the Tucson Facility’s real estate (the “2nd Deed Note”) to 123
2 investors in multiple states.

3 **A. False Statement Regarding the Use of Proceeds**

4 39. To solicit investors for the 2nd Deed Note offering, Byrne and Herlean
5 authorized CapSource’s sales staff to distribute a Loan Summary (prepared by Byrne
6 and signed and certified as true by Individual 1) that deceived potential investors
7 about the true purpose of the offering; in essence, to cover-up the misuse of proceeds
8 from previous offerings.

9 40. The 2nd Deed Note Loan Summary stated: “The subject loan is for
10 continued renovation of the property [the Tucson Facility].”

11 41. At the time the Loan Summary was distributed to investors, Byrne and
12 Herlean (and thus CapSource) knew, or were reckless in not knowing, that the use of
13 proceeds language in the Loan Summary was false.

14 42. For example, on January 19, 2018, Byrne, Herlean, and Individual 1 met
15 and developed a budget showing that proceeds from the 2nd Deed Note offering
16 would be used to repay improper transfers from other projects, as well as to make
17 Company A’s payroll and to establish interest reserves for not only Company A, but
18 several other projects unrelated to Company A’s business. These uses of the
19 proceeds, especially the payment of millions of existing liabilities (i.e., diverted funds
20 from other projects) as opposed to having funds available of future renovation, were
21 inconsistent with what was represented to investors in the 2nd Deed Note.

22 43. The false statement about the use of proceeds was material as a
23 reasonable investor would want to know about the improper diversion of funds.

24 **B. False Statement Regarding the Value of the 2nd Deed Note**
25 **Collateral**

26 44. The Loan Summary also provided a collateral value for the 2nd Deed
27 Note of \$91.5 million based on a purported third-party valuation of “the property
28 securing this loan.”

1 45. At the time the Loan Summary was distributed to investors, Byrne and
2 Herlean (and thus CapSource) knew, or were reckless in not knowing, that the
3 collateral value in the Loan Summary was false insofar as it was not based on an
4 appraisal of the real estate securing the loan (i.e., the Tucson Facility), but was
5 instead based on an enterprise value of Company A's business as a going concern.

6 46. Moreover, unlike the 1st Deed Note Loan Summary, the 2nd Deed Note
7 Loan Summary did not disclose the acquisition cost of the collateral (~\$8.2 million),
8 which was substantially less than the \$91.5 million collateral value provided.

9 47. The false statement about the collateral value was material as a
10 reasonable investor would have wanted to know that the third party appraisal was, in
11 fact, not valuing the property securing the loan, but was instead estimating Company
12 A's going concern value.

13 **C. False Statement Regarding Individual 1's Creditworthiness**

14 48. Individual 1, in addition to being chief executive officer and sole
15 manager of Company A, was the guarantor of the note interests CapSource offered
16 and sold for Company A's subsidiaries.

17 49. As such, Individual 1 signed a certification in the 2nd Deed Note Loan
18 Summary that stated: "I certify that all of the above information contained in the
19 above Loan Summary is true and correct and that I have sufficient income, liquidity
20 and cash flow to make the proposed payments as well as all my other obligations."

21 50. At the time the Loan Summary was distributed to investors, Byrne and
22 Herlean (and thus CapSource) knew, or were reckless in not knowing, that Individual
23 1's certification was false.

24 51. Prior to the 2nd Deed Note offering, Individual 1 defaulted on an
25 approximately \$7 million bank loan secured by his 19,475 square foot residence due
26 to Individual 1's inability to pay. Following the 2nd Deed Note offering, Individual 1
27 assigned ownership of the home to his bank to avoid foreclosure, leaving the bank to
28 sell the property for significantly less than the amount Individual 1 owed.

1 52. Individual 1 informed Byrne of his home loan default in June 2016.
2 Individual 1 subsequently informed Herlean of the default no later than April 2017.

3 53. Defendants did not disclose that Individual 1 was, at the time of 2nd Deed
4 Note offering, in default of his approximately \$7 million dollar home loan due to his
5 inability to pay.

6 54. The false statement about Individual 1's creditworthiness was material
7 as a reasonable investor would have wanted to know of Individual 1's multi-million
8 dollar home loan default, which reflects an inability to satisfy his personal guaranties
9 on the millions of dollars of note interests CapSource offered and sold to investors for
10 projects managed by Individual 1. Indeed, on its website, CapSource described such
11 personal guaranties as being "essential" to "every" note interest offering.

12 **D. False Statements Regarding Individual 1's Delinquent Interest**
13 **Payments for April 2018**

14 55. Given the large amount of funds that Company A was seeking to raise
15 from investors in the 2nd Deed Note offering, CapSource was unable to fund the
16 offering fast enough to allow Individual 1's entities, including some associated with
17 Company A, to make all of their April 2018 interest payments when due.

18 56. Herlean instructed CapSource's staff to send an email (that was sent on
19 May 3, 2018) to all of the investors in the Company A-related notes. That email
20 blamed CapSource's third-party loan service provider ("Company B") for late interest
21 payments (instead of Individual 1) and stated that Individual 1 had made the April
22 interest payments to Company B when, in fact, such payments were not made.

23 57. At the time Herlean approved sending the email to investors he (as well
24 as Byrne) knew, or was reckless in not knowing, that the email was false and that
25 Individual 1's entities were still approximately \$200,000 delinquent on the April
26 interest payments for ten notes, one of which was associated with Company A.

27 58. Despite Herlean's effort to prevent investors from verifying the accuracy
28 of the CapSource communication by obscuring Company B's name, an investor

1 contacted Company B to inquire about the supposed accounting error referenced in
2 the May 3 email.

3 59. When CapSource's operations staff informed Herlean of the investor's
4 inquiry to Company B, he responded: "Well we have to deal with this and be vague
5 as long as it takes to catch up [Individual 1's interest] payments or else all funding for
6 [Individual 1] loans will stop."

7 60. By mid-2018, CapSource was able to close additional funding for the 2nd
8 Deed Note offering. With Byrne's and Herlean's knowledge and approval,
9 Individual 1 used some of these funds to make interest payments to existing investors
10 in order to temporarily bring his entities' notes current.

11 61. The false statements made in the May 3 email Herlean composed were
12 material as a reasonable investor would have wanted to know 1) that Individual 1's
13 entities had not made their interest payments to Company B, and 2) that CapSource
14 was concealing the defaults.

15 **IV. The Fraudulent \$4 Million Regulation D Offering**

16 62. Individual 1's practice of diverting and commingling funds from other
17 CapSource-funded projects to keep Company A afloat continued into mid-2018,
18 when he improperly transferred at least another approximately \$1.3 million from
19 other projects to fund Company A's Tucson Facility. On July 26, 2018, Individual 1
20 circulated an updated schedule to Byrne and Herlean showing that Company A's
21 Tucson Facility still owed millions to various other Individual 1-related projects due
22 to the improper transfers.

23 63. Meanwhile, by July 2018, Company A had incurred additional losses
24 and had negative equity (accumulated losses) in excess of \$7.3 million on a cash
25 basis. Byrne and Herlean knew, or were reckless in not knowing, about these losses.

26 64. Knowing of Company A's losses, Byrne and Herlean agreed to assist
27 Individual 1 with raising funds through an offering of equity securities that, as Byrne
28 wrote in an August 16, 2018 email, "will allow us to replenish the money borrowed

1 by [Company A] from various other deals to fund [Company A's] shortfalls.”

2 65. From mid-August to late September 2018, CapSource, on behalf of
3 Individual 1 and two subsidiaries of Company A, offered and sold \$4 million of
4 equity to 19 investors (the “\$4M Reg. D” offering”) in multiple states, representing
5 an aggregate three percent ownership stake in the two Company A subsidiaries.

6 **A. False Statement Regarding the Use of Proceeds**

7 66. To solicit investors for the \$4M Reg. D offering, Byrne and Herlean
8 authorized CapSource’s sales staff to share with potential investors an offering
9 memorandum (“Offering Memo”) (prepared by Byrne, Herlean, and Individual 1)
10 that contained several material misstatements and omissions.

11 67. The Offering Memo described the securities offered and stated that the
12 proceeds of the offering were to be used “for continued renovation of the property
13 [the Tucson Facility] as well as the available credit lines which will cover the lapse in
14 timing delays of payments from insurance companies.”

15 68. At the time the Offering Memo was distributed to investors, Byrne and
16 Herlean (and thus CapSource) knew, or were reckless in not knowing, that the use of
17 proceeds language in the Offering Memo was false.

18 69. Contrary to the use of proceeds disclosure in the Offering Memo,
19 approximately half of the \$4M Reg. D offering proceeds were used to pay down
20 *existing* liabilities, including some of the improperly diverted funds from other
21 projects, as well as to pay an undisclosed six percent commission, approximately
22 \$240,000, to CapSource.

23 70. The false statement about the use of proceeds was material as a
24 reasonable investor would want to know of the improper diversion of funds that had
25 occurred and its magnitude, and that CapSource was being paid to sell the offering
26 (and the amount of its compensation).

1 **B. Misleading Statement Regarding Potential Profits**

2 71. As authorized by Byrne and Herlean, CapSource’s sales staff sent
3 excerpts from the Offering Memo, including a chart stating that investors could
4 expect an average annual rate of return of 17.95%, via blast email to over 350
5 potential investors without regard to their accreditation or sophistication.

6 72. At the time the Offering Memo excerpts were distributed to investors,
7 Byrne and Herlean (and thus CapSource) knew, or were reckless in not knowing, that
8 the aggressive profit projections provided to investors were misleading as they were
9 not in line with Company A’s history of multi-million dollar operating losses.

10 73. Although Company A’s financials were known to or would have been
11 available to the Defendants, neither Byrne, Herlean, nor anyone else at CapSource
12 disclosed any information to investors concerning Company A’s historical operating
13 losses and negative equity.

14 74. The misleading statement about potential profits was material as a
15 reasonable investor would have wanted to know that those projections deviated
16 substantially from Company A’s historical losses.

17 **V. The Fraudulent Debt Conversion Offering**

18 75. By January 2019, Company A was still unable to generate and collect
19 sufficient revenues to meet its debt obligations, and its subsidiaries defaulted on their
20 notes, including the 1st Deed Note and 2nd Deed Note.

21 76. In response, Byrne and Herlean formulated a restructuring plan with
22 Individual 1 to help Company A reduce its debt burden, which, at this point, required
23 interest payments to investors on around \$24 million in notes. The plan involved a
24 debt-for-equity offering (the “Debt Conversion” offering) where investors could
25 convert their defaulted note interests into equity in a newly-created entity managed by
26 Byrne (“Company C”). In return for the debt relief for Company A, Individual 1
27 transferred his ownership interest in the Company A subsidiary that owned the
28 Tucson Facility’s real estate to Company C.

1 77. CapSource’s sales staff aggressively pitched the Debt Conversion
2 offering to the Company A-related note investors.

3 78. Approximately 247 investors in multiple states agreed to convert to
4 Company C equity, reducing Company A’s debt burden by approximately \$13.9
5 million.

6 79. To solicit investors for the Debt Conversion offering, Byrne and Herlean
7 authorized CapSource’s sales staff to share a brochure for Company A (the
8 “Marketing Deck”) (prepared by Individual 1) with over 300 investors in the
9 Company A-related notes.

10 80. Among other things, the Marketing Deck included a valuation that
11 assigned a going-concern value to Company A of between \$55.8 and \$65.8 million
12 based on multi-million dollar profit projections (which were also shared with the
13 investors). Byrne and Herlean also both touted an approximately \$50 million
14 valuation of Company A during an interstate conference call with Individual 1 and
15 over 100 of the Company A-related note investors on January 31, 2019.

16 81. At the time CapSource distributed the Marketing Deck to investors and
17 at the time of the January 31st investor call, Byrne and Herlean (and thus CapSource)
18 knew, or were reckless in not knowing, that the valuations and profit projections for
19 Company A provided to investors were misleading as they were not in line with
20 Company A’s history of multi-million dollar operating losses.

21 82. Although Company A’s financials were known to or would have been
22 available to the Defendants, they failed to disclose to investors Company A’s
23 historical operating losses.

24 83. The misleading statements about the value of Company A were material
25 as a reasonable investor would want to know that the valuations were based on profit
26 projections that deviated substantially from Company A’s historical losses.

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1 **VI. The Defendants Offered and Sold Securities**

2 84. CapSource offered and sold investments that are “securities” as defined
3 in Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act [15
4 U.S.C. §§ 77b(a)(1) and 78c(a)(10)].

5 85. Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the
6 Exchange Act define “security” to include, among other things, any “note” or
7 “investment contract.”

8 86. The securities offered and sold through CapSource included the
9 following:

- 10 a. For the 2nd Deed Note offering, CapSource offered and sold note
11 interests to approximately 123 investors. These note interests are
12 securities in the form of “notes” and “investment contracts” as
13 they involved a pooled investment of money intended to generate
14 passive profits for the investors.
- 15 b. For the \$4M Reg. D offering, CapSource offered and sold equity
16 interests in two subsidiaries of Company A to approximately 19
17 investors. These equity interests are “investment contracts” as
18 they involved a pooled investment of money intended to generate
19 passive profits for the investors.
- 20 c. For the Debt Conversion offering, CapSource offered and sold
21 equity interests in Company C to approximately 247 investors.
22 These equity interests are “investment contracts” as they involved
23 a pooled investment of assets (namely, converted note interests)
24 intended to generate passive profits for the investors.

25 87. Byrne and Herlean were each indirect sellers, or in the alternative,
26 necessary and substantial participants in the securities offerings identified above
27 involving CapSource.

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1 88. Byrne and Herlean, as the principals of CapSource, helped arrange the
2 offerings and prepared or approved the offering materials (including the 2nd Deed
3 Note Loan Summary, \$4M Reg. D Offering Memo, and Debt Conversion Marketing
4 Deck) that were distributed to investors by CapSource's sales staff (which Herlean
5 supervised). As such, their actions were integral to the success of the offerings.

6 89. No registration statement was filed or in effect with the SEC pursuant to
7 the Securities Act with respect to the securities offered and sold by the Defendants as
8 described herein, and no exemption from registration existed with respect to those
9 securities.

10 **VII. Each of the Defendants Knowingly or Recklessly Made and Disseminated**
11 **Material Misrepresentations**

12 90. As set forth above, each of the Defendants knowing or recklessly made
13 or distributed false or misleading statements to investors when soliciting them for the
14 2nd Deed Note, \$4M Reg. D, and Debt Conversion offerings.

15 91. Byrne and Herlean, as executives and substantial owners of CapSource,
16 had the power to act and did act on behalf of CapSource and, thus, their actions
17 alleged herein, as well as their state of mind, is imputed to CapSource.

18 92. As set forth above, each of the false and misleading statements
19 referenced herein with respect to the 2nd Deed Note, \$4M Reg. D, and Debt
20 Conversion offerings were material at the time they were made and distributed.
21 Those statements address fundamental aspects of the investments, including: 1) the
22 intended use of the proceeds; 2) the integrity of Company A's management (e.g.,
23 improper commingling/misuse of funds); 3) the historical profitability of Company
24 A; 4) the creditworthiness of Individual 1 (e.g., prior defaults); 5) the value of the
25 collateral/assets to be acquired; or 6) whether persons selling the securities (e.g.,
26 CapSource) had an undisclosed conflict of interest (e.g., undisclosed commissions).

1 **VIII. The Defendants Misrepresentations Were Made and Disseminated “In the**
2 **Offer or Sale” and “In Connection with the Purchase or Sale” of**
3 **Securities**

4 93. The misstatements and omissions alleged herein were made and
5 disseminated by the Defendants to induce investors to acquire the securities offered
6 through the 2nd Deed Note, \$4M Reg. D, and Debt Conversion offerings.

7 94. For example, a number of the misstatements and omissions alleged
8 herein were made in the written offering materials disseminated to investors by
9 CapSource, such as the 2nd Deed Loan Summary, the \$4M Reg. D Offering Memo,
10 and the Debt Conversion Marketing Deck.

11 95. As such, the Defendants made and disseminated material misstatements
12 and omissions in the offer or sale of securities as defined in Section 2(a)(1) of the
13 Securities Act and in connection with the purchase or sale of securities as defined in
14 Section 3(a)(10) of the Exchange Act [15 U.S.C. §§ 77b(a)(1) and 78c(a)(10)].

15 **IX. The Defendants Acted as Unregistered Brokers**

16 96. Each of the Defendants acted as a “broker” as defined in Section
17 3(a)(4)(A) of the Exchange Act [15 U.S.C. 78c(a)(4)(A)].

18 97. CapSource offered and sold over \$151 million in securities of
19 approximately 60 issuers, in the form of note and equity interests, to hundreds of
20 unrelated investors nationwide.

21 98. CapSource, through the actions of its employees (including Byrne and
22 Herlean), prepared and/or distributed all of the written materials to investors in
23 connection with those offerings.

24 99. CapSource, through its internal sales force and external finders
25 (overseen by Herlean), determined which investors to solicit and actively and
26 aggressively sought out these investors through calls, blast-emails, advertising, and
27 seminar presentations conducted by Herlean.

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1 100. CapSource, through Byrne, also located the borrowers and performed
2 due diligence on the projects funded via CapSource and presented its assessments to
3 investors (e.g., the Loan Summaries), describing the securities and the purported
4 return/value associated with them.

5 101. Neither Byrne nor Herlean were ever employees of any Company A-
6 related issuers (or many other issuers), for whom they participated in securities
7 offerings.

8 102. CapSource received transaction-based compensation for each note
9 interest offering in the form of percentage-based fees and, in the case of the \$4M
10 Reg. D offering, a six percent commission.

11 103. Byrne and Herlean, as owners of CapSource, received a share of these
12 transaction-based profits.

13 104. In addition, Herlean had an ownership stake in some of CapSource's
14 external finders, thereby permitting him to share in the commissions CapSource paid
15 to those entities for referring investors who acquired securities in the offerings.

16 105. Neither CapSource, Byrne, nor Herlean have never been registered with
17 SEC as a broker or associated with a broker-dealer registered with the SEC.

18 **FIRST CLAIM FOR RELIEF**

19 **(All Defendants)**

20 **Violations of Section 10(b) of the Exchange Act and Rule 10b-5**

21 **[15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5]**

22 106. The SEC realleges and incorporates by reference above paragraphs 1
23 through 105.

24 107. During the Relevant Period, each of the Defendants, directly or
25 indirectly, in connection with the purchase or sale of a security, and by the use of
26 means or instrumentalities of interstate commerce, of the mails, or of the facilities of
27 a national securities exchange, knowingly and recklessly: (a) employed devices,
28 schemes, or artifices to defraud; (b) made untrue statements of a material fact or

1 omitted to state a material fact necessary in order to make the statements made, in the
2 light of the circumstances under which they were made, not misleading; and (c)
3 engaged in acts, practices, or courses of business which operated or would operate as
4 a fraud or deceit upon other persons.

5 108. By engaging in the conduct described above, each of the Defendants
6 violated, and unless restrained and enjoined will continue to violate, Section 10(b) of
7 the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. §
8 240.10b-5].

9 **SECOND CLAIM FOR RELIEF**

10 **(All Defendants)**

11 **Violations of Sections 17(a) of the Securities Act**

12 **[15 U.S.C. § 77q(a)]**

13 109. The SEC realleges and incorporates by reference above paragraphs 1
14 through 105.

15 110. During the Relevant Period, each of the Defendants, directly or
16 indirectly, in the offer or sale of securities by the use of means or instruments of
17 transportation or communication in interstate commerce or by use of the mails,
18 knowingly, recklessly, and negligently: (a) employed devices, schemes, or artifices to
19 defraud; (b) obtained money or property by means of untrue statements of a material
20 fact or by omitting to state a material fact necessary in order to make the statements
21 made, in light of the circumstances under which they were made, not misleading; and
22 (c) engaged in transactions, practices, or courses of business which operated or would
23 operate as a fraud or deceit upon the purchaser.

24 111. By engaging in the conduct described above, each of the Defendants
25 violated, and unless restrained and enjoined will continue to violate, Section 17(a) of
26 the Securities Act [15 U.S.C. § 77q(a)].
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THIRD CLAIM FOR RELIEF

(All Defendants)

Violations of Sections 5(a) and 5(c) of the Securities Act

[15 U.S.C. §§ 77e(a) and 77e(c)]

112. The SEC realleges and incorporates by reference above paragraphs 1 through 105.

113. During the Relevant Period, each of the Defendants, directly or indirectly: (a) made use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell, through the use or medium of a prospectus or otherwise, securities, including, but not limited to, those identified in Paragraph 106, as to which no registration statement has been in effect and for which no exemption from registration has been available; (b) for the purpose of sale or for delivery after sale, carried or caused to be carried through the mails or in interstate commerce, by any means or instruments of transportation, securities, including, but not limited to, those identified in Paragraph 106, as to which no registration statement has been in effect and for which no exemption from registration has been available; and (c) made use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell, through the use of medium of any prospectus or otherwise, securities, including, but not limited to, those identified in Paragraph 106, as to which no registration statement has been in effect and for which no exemption from registration has been available.

114. By engaging in the conduct described above, each of the Defendants violated, and unless restrained and enjoined will continue to violate, Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§ 77e(a) and 77e(c)].

1 **FOURTH CLAIM FOR RELIEF**

2 (All Defendants)

3 **Violations of Section 15(a) of the Exchange Act**

4 **[15 U.S.C. § 78o(a)]**

5 115. The SEC realleges and incorporates by reference above paragraphs 1
6 through 105.

7 116. During the Relevant Period, each of the Defendants, directly or
8 indirectly, by the use of the mails or the means or instrumentalities of interstate
9 commerce, while acting as broker-dealers, effected transactions in, or induced or
10 attempted to induce the purchase or sale of securities, while they were not registered
11 with the SEC as brokers or dealers or when they were not associated with an entity
12 registered with the SEC as a broker-dealer.

13 117. By engaging in the conduct described above, each of the Defendants
14 violated, and unless restrained and enjoined, will continue to violate Section 15(a) of
15 the Exchange Act [15 U.S.C. § 78o(a)].

16 **PRAYER FOR RELIEF**

17 WHEREFORE, the SEC respectfully requests that the Court:

18 **I.**

19 Issue findings of fact and conclusions of law that each of the Defendants
20 committed the alleged violations.

21 **II.**

22 Issue judgments, in forms consistent with Rule 65(d) of the Federal Rules of
23 Civil Procedure, permanently enjoining each of the Defendants from violating
24 Sections 5(a), 5(c), and 17(a) of the Securities Act [15 U.S.C. §§ 77e(a), 77e(c), and
25 77q(a)] and Sections 10(b) and 15(a) of the Exchange Act [15 U.S.C. §§ 78j(b) and
26 78o(a)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

1 **III.**

2 Order each of the Defendants to disgorge all ill-gotten gains received during
3 the period of violative conduct and pay prejudgment interest on such ill-gotten gains.

4 **IV.**

5 Order each of the Defendants to pay civil penalties pursuant to Section 20(d) of
6 the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15
7 U.S.C. § 78u(d)(3)].

8 **V.**

9 A jury trial on all issues triable to the jury.

10 **VI.**

11 Retain jurisdiction of this action in accordance with the principles of equity and
12 the Federal Rules of Civil Procedure in order to implement and carry out the terms of
13 all orders and decrees that may be entered, or to entertain any suitable application or
14 motion for additional relief within the jurisdiction of this Court.

15 **VII.**

16 Grant such other and further relief as this Court may determine to be just and
17 necessary.

18
19 Dated: December 21, 2020

20 */s/ Terry R. Miller*

21

Terry R. Miller (*pro hac vice*)

22 Attorney for Plaintiff

23 Securities and Exchange Commission
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