UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, **Plaintiff,** **v.** **NORTHRIDGE HOLDINGS, LTD., SOUTHRIDGE HOLDINGS, LTD., EASTRIDGE HOLDINGS, LTD., BROOKSTONE INVESTMENT GROUP, LTD., GUARDIAN INVESTMENT GROUP, LTD., UNITY INVESTMENT GROUP, LTD., AMBERWOOD HOLDINGS L.P., and GLENN C. MUELLER.** **Defendants.**	**Civil Action No. 19-cv-5957**

PLAINTIFF'S MEMORANDUM IN SUPPORT OF ITS
EMERGENCY MOTION FOR A TEMPORARY RESTRAINING ORDER
TO PREVENT VIOLATIONS OF THE FEDERAL SECURITIES LAWS,
TO APPOINT A RECEIVER, AND PROVIDE FOR OTHER ANCILLARY RELIEF

Dated: September 5, 2019

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Plaintiff U.S. Securities and Exchange Commission ("SEC") respectfully submits this memorandum in support of its motion for a temporary restraining order, the appointment of a receiver, and other relief.[1] The relief requested in this memorandum is reflected in the proposed orders attached as Exhibits 1 and 2 to the SEC's motion, which has been filed contemporaneously herewith. In further support of the motion, the SEC also submits the accompanying declarations of Wilburn Saylor, Jr., Robert Stefan, Thomas R. Wilder, Timothy K. Smith, Patricia Petroff, JoAnn McGarry, and Glenn Mueller.

INTRODUCTION

Since at least May 2014, Illinois property developer Glenn Mueller ("Mueller") has conducted a fraudulent, unregistered securities offering through Northridge Holdings, Ltd. ("Northridge") and affiliated entities he owns and controls. In the last five years, Defendants fraudulently offered and sold promissory notes totaling at least $41.6 million, in unregistered transactions, to over 300 investors across 32 states, many of whom were unsophisticated and/or unaccredited and of retirement age.

Mueller and his company, Northridge, purported to generate returns for investors through the strategic acquisition of underperforming real estate, primarily large apartment complexes and other multi-family properties located in Illinois. On Northridge's website, in its marketing materials and through direct communications Mueller had with investors, Mueller and Northridge represented that investors' funds would be used to purchase and renovate such properties, resulting

[1] Given the many issues addressed herein and the nature of the alleged misconduct, this brief exceeds the page limitations set forth in Local Rule 7.1. Accordingly, the SEC hereby seeks leave to file this oversize brief *instanter*.

in profits derived from higher occupancies and rents, and/or the re-sale of properties or individual units. But while Northridge portrayed itself as an opportunistic fix-and-flip investor, in reality it was (and is) a landlord struggling to make ends meet. Most of Northridge's properties were purchased at least twelve years ago and since then it has sold little of its overall real estate portfolio. Moreover, Northridge has consistently failed to generate sufficient cash flow from the properties to cover its expenses.

Thus, for the past five years or more, Northridge has been propped up by a precarious foundation of new investor money. In Ponzi fashion, and contrary to the representations to investors, Defendants used significant amounts of the funds raised from new investors to pay promised distributions to earlier investors and to pay "finders" who referred investors to Northridge, to trade stock and options, and to make purported loans to members of Mueller's family. Mueller perpetuated this fraudulent scheme, in substantial part, through the continuous offer and sale of promissory notes, with terms ranging from one to eight years and annual interest rates of 3% to 12%. While Mueller promoted the investments under the Northridge moniker, he typically issued investors unsecured notes in the name of shell companies which had no meaningful assets. Nevertheless, Mueller reassured investors the notes were "backed" by all of Northridge's underlying properties, falsely suggesting a margin of security that did not actually exist, given the debt and equity structure of the business.

According to their records, the entity Defendants collectively owe in excess of $41 million in total promissory note debt. Each year between 2014 and 2018, the outstanding promissory note debt of the Northridge real estate operation grew (on top of mortgage debt of over $40 million), and internal financial reporting revealed annual net losses and negative net assets. Yet all the while, in marketing materials and sales pitches, Mueller and Northridge touted their purported financial success and falsely portrayed their investment offerings as "safe" and "low-risk." Defendants continued to offer and sell promissory notes through at least April 2019.

The SEC seeks to stop Defendants' unlawful activities. The SEC also seeks the appointment of a receiver to remove Defendants' control over investors' funds, secure the real estate and other assets obtained with investor proceeds, and ultimately recompense the defrauded investors.

FACTUAL BACKGROUND

A. The Defendants

Northridge is a North Dakota corporation with its principal place of business in Addison, Illinois. (Declaration of Wilburn Saylor, Jr. attached as Exhibit A ("Saylor Decl."), ¶ 7.) Mueller is the sole owner and President of Northridge, and Mueller manages all aspects of Northridge's business activities, including the purchase, development and financing of real estate projects. (*Id.*, ¶¶ 4, 12.)

Mueller also created Southridge Holdings, Ltd. ("Southridge"), Eastridge Holdings, Ltd. ("Eastridge"), Brookstone Investment Group, Ltd. ("Brookstone"), Guardian Investment Group, Ltd. ("Guardian"), Unity Investment Group I, Ltd. ("Unity"), and Amberwood Holdings, L.P. ("Amberwood") (collectively with Northridge, the "Defendant Entities"). (*Id.*, ¶ 4(a).) The Defendant Entities are Illinois corporations owned by Mueller, except for Amberwood, which is an Illinois limited partnership owned by Mueller and members of his family. (*Id.*, ¶ 7.) Mueller controls the Defendant Entities, including their operations, bank accounts, and representations made to investors. (*Id.*, ¶ 12.)

B. Northridge's Business and Management

Northridge's business objective, according to its marketing materials, "is to purchase undervalued or mismanaged, income producing apartment buildings through leveraged financing; then increase their value by improving their appearance, increasing income and reducing expenses." (*Id.*, ¶ 31(b).) Northridge's brochure, which was provided to potential investors and finders (individuals paid to find investors) (*id.*, ¶ ¶ 15, 25), explained "How Northridge Works," which includes: (1) identify rental property "poised for significant increase"; (2) after purchasing the property, form a limited partnership of investors; (3) either convert the complex to condos and sell off the units individually or continue operating as a rental property; (4) make "key improvements to lower expenses and raise monthly income"; and (5) when the property value reaches "an optimal level," "sell it for cash." (*Id.*, ¶ 31(c), Ex. 7.) The brochure also advertised Northridge's purported "track record of credible money management" and stated that "[i]ntegrity" was "the linch-pin" of the business. (*Id.*, ¶¶ 31(a), (d), Ex. 7.)

As of February 2019, Northridge operated 11 different properties totaling 935 units. (*Id.*, ¶ 37.) Mueller and Northridge organized at least 16 different real estate limited partnerships, corporations, and trusts (collectively, "Real Estate Entities") to hold the respective real estate properties or real estate funds, (*id.*, ¶ 4(b)), and also formed other entities that charged the Real Estate Entities for property management services (*id.*, ¶ 57). Northridge has around a 1% ownership interest in each of the Real Estate Entities, and as general partner, is entitled to a fee typically in an amount equal to 5% of all cash revenue and proceeds of the corresponding real estate partnership for operating and managing the property. (*Id.*, ¶¶ 4(b), 57(a).) Also, Amberwood (Mueller's family limited partnership) owns a 40% interest in the Real Estate Entities without contributing any capital.

(*Id.*, ¶ 8(c).) Mueller and Northridge sold ownership interests in the Real Estate Entities to outside investors to help finance initial property acquisition and renovation costs. Those investors share the remaining 60% of profits or losses, according to their percentages of capital investment. (*Id.*, ¶ 16, n. 3.)

Despite Mueller and Northridge's representations, Northridge has not been in the business of "flipping" residential buildings, that is, purchasing distressed buildings, rehabbing the units, and then selling the buildings at a profit. (*Id.*, ¶ 37.) Although Northridge's marketing materials provide various examples of it buying and selling properties between 1995 and 2006, with turnarounds of one to three years and alleged returns ranging from 50% to 100% or more, Northridge has purchased only one building in the last 12 years – a small office building for $535,000. (*Id.*, ¶ 37; Group Ex. 14.) In the ensuing years, Northridge has sold only two small residential buildings (approximately 56 units combined), whose sale resulted in a lawsuit against Northridge, causing Mueller to ask a large investor for money to help cover legal costs. (*Id.*, Ex. 12.) Nevertheless, Northridge has reported steadily increasing unrealized gains to Real Estate Entity investors in account statements available on Northridge's website (*Id.*, ¶¶ 19, 74.)

C. Defendants' Continuous, Unregistered Promissory Note Offering

Since at least May 2014, Defendants engaged in a continuous offering of promissory note investments. (*Id.*, ¶¶ 13-16, Exs. 3, 4.) Defendants offered "real estate promissory notes," which were to pay annual interest of 3% until the funds were invested in a specific property. (*Id.*, ¶ 13.) They simultaneously offered promissory notes that Mueller and Northridge advertised as "CDs" or "CD loans," which had terms ranging from one to five years or more and annual interest rates ranging from 3% to 6%, depending on the length of the note. (*Id.* ¶ 14.) Certain noteholders who invested larger amounts of money or agreed to longer terms received interest rates as high as 12%. (*Id.*) Northridge would either pay periodic interest payments or promise to pay principal and accrued interest upon a note's maturity. (*Id.*, ¶ 19.) Most note investors elected to accrue interest and renew their notes at maturity. (*Id.*, ¶ 20.)

Defendants offered the notes to the public on an ongoing basis, including through newsletters available on Northridge's website and through finders located in 10 different states, most of whom were unregistered brokers. (*Id.*, ¶¶ 27-29, 33(d)(vi), Ex. 8.) The marketing materials provided to investors by Northridge and its finders included a schedule of interest rates for the dual "Real Estate Promissory Note" and "CD Loan Promissory Note" investment offering. (*Id.* ¶¶ 15, 25, Ex. 3.)

Although the promissory notes were promoted as an investment in Northridge's real estate business, the vast majority of the notes were issued by Southridge, Eastridge, Brookstone, Guardian, and Unity, which Mueller purportedly created to raise money from different subsets of investors. (*Id.*, ¶¶ 8(a), (b), Ex. 1.) Additional promissory notes were issued by Northridge itself and also Amberwood. (*Id.*, ¶ 8(a), Ex. 1.) Mueller signed the promissory notes on behalf of each of the Defendant Entities. (*Id.*, ¶ 21.)

From at least May 2014 through April 2019, Defendants offered and sold at least $41.6 million in promissory notes to at least 319 investors across 32 states, many of whom were unaccredited and funded investments with their IRA funds. (*Id.*, ¶ 16, Ex. 4.) Of this amount, approximately $23 million was raised from new investments, with the remainder consisting of prior investments that rolled over into new notes. (*Id.*, ¶ 16.) None of the securities or securities offerings were registered with the SEC. (*Id.*, ¶ 17.)

D. Mueller and Northridge's Representations to Investors Regarding Use of Investment Funds and Minimized Risk of Investments.

In Northridge's marketing materials, and in Mueller's direct communications with investors, Northridge and Mueller represented that investors' funds would be used to buy and renovate real estate assets. For example, in Northridge's newsletters, which were available on its website, Mueller and Northridge represented that investor funds "were being put to good use" and were "necessary to purchase, maintain, and improve the properties." (*Id.*, ¶¶ 32(d)(vii), 39, 40, Ex. 11; *see also, e.g.,* Declaration of Thomas R. Wilder ("Wilder Decl."), attached as Ex. B, ¶¶ 6(c), 11; Declaration of Patricia Petroff, attached as Ex. C, ¶ 7; Declaration of Robert Stefan, attached as Ex. D, ¶ 6; Declaration of JoAnn McGarry, attached as Ex. E, ¶ 13.) They also represented to finders and investors that the promissory note investments were "backed" by the equity and cash flow of Northridge's properties, whose values, at least according to Mueller, were increasing. (Wilder Decl., ¶ 6(c), Ex. B; Saylor Decl., ¶ 23, Group Ex. 6.)

In explaining that the properties act as collateral for the promissory notes, Mueller told one or more finders that the notes "are secured by any and all of the properties and their cash flow, thus giving more protection," "[w]e have not seen an increase in risk," "the cash flow and increase[d] value of the properties has been increasing the collateral for the loans," "there is a large surplus of equity above and beyond all of the loans and that number is increasing every year," and "the collateral for the loans continues to grow reducing risk each year." (Saylor Decl., ¶ 23, Group Ex. 6.) Most of the promissory notes, however, were unsecured. (*Id.*, ¶ 22.)

Through Northridge's brochure, website, newsletters, finders, and meetings with potential investors, Mueller and Northridge promoted the promissory notes as safe and Northridge as financially successful with a strong track record of satisfied investors. (*See, e.g., id.*, ¶ 32; McGarry

Decl., ¶¶ 5, 8, 11; Petroff Decl., ¶ 5; Declaration of Timothy K. Smith ("Smith Decl."), attached as Ex. F, ¶¶ 5(b), (f).) At the same time, they marketed community service efforts and partnerships with religious organizations, which led investors to believe that Mueller was trustworthy. (Saylor Decl., ¶¶ 33-35; McGarry Decl., ¶ 10; Wilder Decl., ¶ 9.)

E. Mueller and Northridge Misled Noteholders About the Risks and Nature of Their Investments and Were Operating a Ponzi Scheme.

Contrary to the representations of Northridge and Mueller, Northridge's real estate business was not profitable and, in fact, as of May 31, 2019, the Defendant Entities had a cumulative deficit of approximately $35.6 million while the Real Estate Entities had a cumulative deficit of approximately $16 million. (Saylor Decl., ¶¶ 43-46.) Since at least 2014, the Northridge real estate business has operated with annual negative cash flows and made up these shortfalls through the above described offering of promissory notes, thereby increasing the business's cash obligations to investors (and, in turn, the cyclical need to issue new notes). (*See id.*)

Thus, Mueller and the Defendant Entities operated a Ponzi scheme, wherein they paid earlier promissory note investors with funds raised from more recent promissory note investors.[2] Mueller often diverted investor monies from one Defendant Entity to another to fund such payments. (*Id.*, ¶¶ 42, 53-56.) Deferring repayment, however, was preferable, and essential to the scheme. The promissory notes were structured to automatically renew upon maturity unless certain conditions were met. (*Id.*, ¶ 18.) Many investors agreed to roll-over their notes into new notes based on Northridge's and Mueller's representations regarding safety and profitability, as well as account

[2] Northridge admitted (through its former counsel) that the most recent investments totaling $650,000 were used to pay, among other things, "principal of matured promissory notes and interest expenses affiliated with outstanding promissory notes." (Saylor Decl., ¶ 51, Ex.14.)

statements from Northridge depicting purported gains. (*See, e.g., id.*, ¶¶ 19, 20.) Defendants made periodic distributions of interest and repaid principal, (*id.*, ¶ 20), as needed to perpetuate the scheme.

From May 1, 2014 to April 18, 2019, the Defendant Entities received a total of about $33.5 million, including approximately $23.2 million from promissory note investors. (*Id.*, ¶ 41.) During that same time period, the Defendant Entities disbursed a total of about $33.4 million, including approximately $18.8 million in payments to promissory note investors. (*Id.*, ¶ 41.) Therefore, of the approximate $33.5 million received, 69% was from promissory note investors, and of the $33.4 million disbursed, 56% was used to pay back investors. (*Id.* ¶ 41.) The tracing of Mr. Smith's and Ms. McGarry's funds (set forth in the Saylor Declaration) are just two examples showing how new investor funds were used to pay earlier investors, among other liabilities. (*Id.*, ¶¶ 55, 56.)

In addition to Ponzi payments, Mueller caused Defendants to misuse promissory note investors' funds to pay commissions and consulting fees to finders exceeding $1.8 million, fund brokerage accounts with approximately $1.7 million, which he used to trade stock and options, and to make approximately $647,000 in purported loans to members of his family. (*Id.*, ¶¶ 27, 41, 61.)[3]

Defendants did not disclose to investors that proceeds from their notes would be used to pay other investors, pay finders, fund Mueller's securities trading, or loan money to Mueller's family members, (*id.*, ¶¶ 51, 65), but if they had, this information would have impacted investors' decisions to invest in the promissory notes. (*See, e.g.*, Stefan Decl., ¶ 16; Petroff Decl., ¶¶ 8, 9; Wilder Decl., ¶ 11; McGarry Decl., ¶¶ 13, 14; Smith Decl., ¶ 14.)

[3] In addition, from May 1, 2014 through May 31, 2019, Mueller personally received approximately $1.5 million in salary and other payments, including approximately $435,000 from the Defendant Entities and $1.1 million from one of the real estate trusts and Mueller Painting & Decorating L.P. (which charged the Real Estate Entities for maintenance work). (Saylor Decl., ¶ 59.)

F. Harm to Investors is Ongoing.

By at least March 1, 2019, Mueller and Northridge had notice the SEC was investigating whether they were engaged in unregistered and fraudulent securities offerings. (*Id.*, ¶ 67.) Nonetheless, they continued to unlawfully offer and sell promissory notes and did so without disclosing the SEC's investigation to at least two investors, Timothy K. Smith (who invested $250,000 on March 11, 2019) and Patricia Petroff (who rolled-over her $20,000 note on March 3, 2019), which information would have impacted their investment decisions. (*Id.*, Ex. 4 (page 15 of 16); Smith Decl., ¶ 13; Petroff Decl., ¶ 16.) Moreover, consistent with their customary business practice, Defendants used funds from Mr. Smith's investment and another new investor (who signed a $400,000 note on April 18, 2019) to pay principal and interest to prior investors and finders fees, among other expenses. (Saylor Decl., ¶¶ 14, 51, Exs. 4 (pages 8 and 15 of 16), 14.)

During a March 19, 2019 investor conference call (which was recorded and available on Northridge's website between March 19, 2019 and June 19, 2019), Mueller belatedly disclosed the investigation but tried to downplay its scope. (*Id.*, ¶¶ 66-69.) Among other unsupported assurances, Mueller stated that: "the SEC is not examining the merits of your investments;" is not "looking into how we purchase and manage our real estate;" and he did "not believe that the regulators will examine the fundamentals of our business operations." (*Id.*, ¶¶ 66(a)-(c).) Mueller stated that, "[i]nstead, we believe the focus will be on whether the company should have registered offers and sales of securities with the SEC." (*Id.*, ¶ 66(a).) Mueller further assured investors that Northridge intended "to continue to pay interest on notes in accordance with their terms" and "to honor the terms of the notes in the ordinary course as the company always has," (*id.*, ¶ 66(d)), even though

Mueller knew that Northridge had only been able to pay interest and principal on outstanding notes through the issuance of more notes.

Given the financial condition of the Northridge real estate business, the continued payment of interest and principal to certain investors will result in the dissipation of assets available to repay other investors. According to Northridge's internal records and Mueller's own analysis, the real estate properties have a liquidation value of around $100.4 million and Northridge has liabilities of over $113 million (including approximately $40 million in mortgage debt and an additional $41 million in promissory note debt), (*id.*, ¶¶ 16, 48, 74, 78; Group Ex. 14), translating to an investor loss of at least $13 million, (*id.*, ¶ 74), plus the loss of unrealized gains previously reported to investors in the Real Estate Entities. If Mueller's strategy has been to keep the Northridge business afloat until such time as the properties can be sold at prices sufficient to pay off mortgage lenders, real estate investors, and promissory note investors, that day has yet to arrive and may never come.

During the SEC's pre-suit investigation, the SEC subpoenaed Mueller to provide sworn testimony. In response, Mueller invoked his Fifth Amendment right against self-incrimination and refused to answer any and all questions about the above-described offering of promissory notes, including the use of proceeds, the source of payments to investors, the value of the Northridge-managed real estate properties, and whether Northridge has been, and/or is currently, able to make payments due to investors from operating cash flow, without the issuance of additional promissory notes. (*See* Declaration of Glenn Mueller, attached as Ex. G.)

ARGUMENT

Having recognized the vital need to stop securities fraud and protect investors from ongoing harm, Congress vested the other two branches of government with authority to take swift, decisive action to safeguard the public. Congress expressly empowered the SEC to seek – and district courts to grant – injunctive relief upon a "proper showing" of an ongoing violation of the securities laws. *See* 15 U.S.C. §§ 77v(a), 78aa. Congress vested district courts with vast equitable powers to redress violations of the federal securities laws. "In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, **any** equitable relief that may be **appropriate or necessary** for the benefit of investors." 15 U.S.C. § 78u(d)(5) (emphasis added); *see also Mitchell v. Robert DeMario Jewelry, Inc.,* 361 U.S. 288, 291-92 (1960) ("When Congress entrusts to an equity court the enforcement of prohibitions contained in a regulatory enactment, it must be taken to have acted cognizant of the historic power of equity to provide complete relief in light of the statutory purposes."); *SEC v. Yang*, 795 F.3d 674, 681 (7th Cir. 2015).

The SEC seeks a temporary restraining order – and thereafter a preliminary injunction – against the Defendants to enjoin them from violating the federal securities laws and from, directly or indirectly, soliciting any new investors or accepting additional funds from existing investors. In addition, the SEC seeks emergency ancillary relief, including the appointment of a receiver; an asset freeze; an accounting; a stay of any bankruptcy filings and any ancillary litigation; a document preservation directive; and expedited discovery. Such relief is necessary to preserve the status quo, prevent the dissipation of investor proceeds and to otherwise effectuate the remedial purposes underlying the federal securities laws.

I. This Court Should Temporarily Restrain and Preliminarily Enjoin the Defendants from Further Violations of the Federal Securities Laws.

A. The Federal Securities Laws Protect the Public by Empowering the SEC to Seek Emergency Relief.

After a "proper showing" by the SEC, a "temporary injunction or restraining order shall be granted." *See* 15 U.S.C. §§ 77t(b), 78u(d). "The use of the word 'shall' indicates Congress's clear preference for preliminary injunction relief, where a credible allegation of a violation is made." *SEC v. Bravata*, 2009 WL 2245649, at *4 (E.D. Mich. July 27, 2009).

The standard for a "proper showing" is low. The SEC must have a "justifiable basis for believing, derived from reasonable inquiry and other credible information, that such a state of facts probably existed as reasonably would lead the SEC to believe that the defendants were engaged in violations of the statutes involved." *SEC v. Householder*, 2002 WL 1466812, at *5 (N.D. Ill. July 8, 2002) (quoting *SEC v. Gen. Refractories Co.*, 400 F. Supp. 1248, 1254 (D.D.C. 1975)); *SEC v. Int'l Loan Network, Inc.*, 770 F. Supp. 678, 688 (D.D.C. 1991).

Thus, to obtain a temporary restraining order or a preliminary injunction, the SEC need only show a "likelihood of success as to [establishing] (a) current violations and (b) a risk of repetition." *SEC v. Hollnagel*, 503 F. Supp. 2d 1054, 1058 (N.D. Ill. 2007); *see also SEC v. Holschuh*, 694 F.2d 130, 144 (7th Cir. 1982). In assessing risk of repetition, courts look to factors such "as the gravity of harm caused by the offense; the extent of the defendant's participation and his degree of scienter; the isolated or recurrent nature of the infraction and the likelihood that the defendant's customary business activities might again involve him in such transactions." *Holschuh*, 694 F.2d at 144.

The standard for injunctive relief is different in an SEC enforcement action, given the SEC's unique standing as a guardian of the public interest. Unlike private litigants, the SEC does not need to prove risk of irreparable injury, or establish the unavailability of other remedies, or establish that the balance of equities favor its position. *See, e.g.*, *SEC v. Unifund SAL*, 910 F.2d 1028, 1036 (2d Cir. 1990) ("In our earliest encounters with injunction requests by the Commission, we relieved the Commission of the obligation, imposed on private litigants, to show risk of irreparable injury, or the unavailability of remedies at law.") (citations omitted).

B. The Defendants Have Violated the Federal Securities Laws.

This case satisfies, by a wide margin, the above standard for emergency relief. The Defendants have violated and, unless enjoined, will continue to violate the registration requirements and anti-fraud provisions of the federal securities law.

1. The Defendants Violated the Securities Laws' Registration Provisions.

The Defendants have violated Sections 5(a) and (c) of the Securities Act of 1933 ("Securities Act"). 15 U.S.C. §§ 77e(a), e(c). Under Section 5(a) of the Securities Act, it is unlawful for any person, directly or indirectly, to sell securities through the use of any means or instrumentalities of transportation or communication in interstate commerce or of the mails unless the transaction is the subject of an effective registration statement. 15 U.S.C. § 77e(a). Section 5(c) provides a similar prohibition for offers to sell a security unless a registration statement has been filed. 15 U.S.C. § 77e(c).

"A prima facie violation of Section 5 arises if it is established that the defendant directly or indirectly sold or offered to sell securities, there was no registration statement in effect as to the securities, and the sale was made through interstate facilities or the mails." *SEC v. Randy*, 38 F. Supp. 2d 657, 667 (N.D. Ill. 1999). Once the SEC establishes a prima facie violation, the defendant assumes the burden of proving that the securities qualify for a registration exemption. *Id.*; *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953). Scienter is not required to prove a violation of Section 5. *SEC v. Zenergy Int'l, Inc.*, 141 F. Supp. 3d 846, 852 n.6 (N.D. Ill. 2015); *see also SEC v. Calvo*, 378 F.3d 1211, 1215 (11th Cir. 2004); *SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 859-60 (S.D.N.Y. 1997), *aff'd*, 159 F.3d 1348 (2d Cir. 1998). Here, Defendants offered and sold securities[4] to over 300 investors, raising at least $41.6 million, yet did not register those securities or offerings. Accordingly, the SEC has made a prima facie showing that Defendants violated Section 5.

2. Defendants Violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5(a) and (c), and Sections 17(a)(1) and (a)(3) of the Securities Act.

Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5(a) and (c) thereunder prohibit any person from employing "any device, scheme, or artifice to defraud" or engaging in any "act, practice, or course of business" which operates as a fraud or deceit, in connection with the purchase or sale of a security. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5(a) and (c). Similarly, Section 17(a)(1) and (a)(3) of the Securities Act prohibit any person from, in the offer or sale of a security, employing "any device, scheme, or artifice to

[4] The promissory notes are securities under *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946), because they are investment contracts, which have been defined as: (1) an investment of money; (2) in a common enterprise; and (3) with the expectation of profits to be derived solely from the efforts of others.

defraud" or engaging in any "transaction, practice, or course of business" which operates as a fraud or deceit. 15 U.S.C. § 77q(a)(1) and (3).

The proscriptions in Section 10(b), Rule 10b-5, and Section 17(a) are substantially the same. *SEC v. Maio,* 51 F.3d 623, 631 (7th Cir. 1995). "The principal difference is that § 10(b) and Rule 10b-5 apply to acts committed in connection with a *purchase or sale of* securities while § 17(a) applies to acts committed in connection with *an offer or sale* of securities." *Id.* (emphasis in original) (internal citation omitted).

The language of these provisions is "expansive" and they "capture a wide range of conduct." *Lorenzo v. SEC*, 139 S. Ct. 1094, 1102 (2019). In *Lorenzo*, the Supreme Court held that knowingly disseminating a false statement to investors with the intent to deceive can violate Rules 10b-5(a) and (c) and Section 17(a)(1), even if the defendant is not a "maker" of the statement for purposes of Rule 10b-5(b), as that term was defined in *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011) (the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it, for purposes of Rule 10b-5). The Court rejected Lorenzo's arguments that each subsection of Rule 10b-5 "should be read as governing different, mutually exclusive, spheres of conduct" and that all conduct relating to false statements must be charged under Rule 10b-5(b) or, by extension, Section 17(a)(2). *Lorenzo*, 139 F. Ct. at 1102-03. Rather, the Court emphasized, there is "considerable overlap among the subsections of" Rule 10b-5 and Section 17(a), and thus the same underlying conduct may establish a violation of more than one subsection. *Id.* at 1102 (citing *Herman & MacLean v. Huddleston*, 459 U.S. 375, 383 (1983) ("it is hardly a novel proposition that" different portions of the securities laws "prohibit some of the same conduct")).

Proof of scienter is required for Section 10(b), Rules 10b-5(a) and (c), and Section 17(a)(1), whereas negligence is sufficient for Section 17(a)(3). *Aaron v. SEC*, 446 U.S. 680, 691 & 697 (1980); *Holschuh*, 694 F.2d at 143. Scienter is "a mental state embracing intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976); *SEC v. Bauer*, 723 F.3d 758, 775 (7th Cir. 2013). "Reckless disregard of the truth also satisfies the scienter requirement, as does 'deliberate ignorance.'" *SEC v. Kelly*, 545 F. Supp. 2d 808,811 (N.D. Ill. 2008) (quoting *SEC v. Jakubowski*, 150 F.3d 675, 681-82 (7th Cir. 1998)). Because Mueller owned and controlled the Defendant Entities, his scienter can be imputed to them. *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1089 n.3, 1097 n.18 (2d Cir. 1972) (finding that scienter of those controlling a company can be imputed to the company).

Here, the Defendants intentionally engaged in a number of deceptive acts in violation of Section 17(a)(1) and (3) and Rule 10b-5(a) and (c). Northridge and Mueller falsely portrayed the notes as safe and secure investments that would generate profits from rental incomes or sales of previously underperforming apartment buildings turned around by Northridge. Defendants, however, knew they lacked the cash flow or liquidity to repay the interest and principal of notes when due, thus they continually sought to defer repayment further into the future, including by structuring the notes to automatically renew upon maturity, and when unable to do so, used a steady stream of new investor funds to make payments owed to earlier investors.

Defendants further created the appearance that Northridge was investing funds and generating returns as promised by making periodic distributions to those seeking a fixed income stream. Mueller often transferred, or directed the transfer, of investor monies from one Defendant entity to another to fund such payments. The payments lulled investors and induced them to maintain and renew their investments with Northridge, including by rolling-over maturing note balances into new notes.

In addition to Ponzi payments, Defendants used the proceeds of promissory note investments for other undisclosed purposes, including payment of substantial amounts to finders, for securities trading and loans to members of Mueller's family. Ponzi schemes where investor funds are diverted for undisclosed uses or personal benefit are a well-recognized form of a scheme to defraud. *See Burnett v. Rowzee*, 561 F. Supp. 2d 1120, 1127-28 (C.D. Cal. 2008) (Ponzi payments create a false appearance of exceptional returns, thus satisfying scheme liability); *see also In re World Vision Ent., Inc.,* 275 B.R. 641, 656 (M.D. Fla. 2002) ("A Ponzi scheme is by definition fraudulent. By extension, any acts taken in furtherance of the Ponzi scheme, such as paying brokers' commissions, are also fraudulent.").

3. Mueller and Northridge Violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5(b), and Defendants Violated Section 17(a)(2) of the Securities Act.

Section 10(b) of the Exchange Act and Rule 10b-5(b) prohibit any person from "making any untrue statement of a material fact" or "omit[ting] 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," in connection with the purchase or sale of a security. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5(b). For purposes of Rule 10b-5(b), "the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Janus Capital Group*, 564 U.S. at 142. Section 17(a)(2) of the Securities Act prohibits any person from, in the offer or sale of a security, "obtain[ing] money or property by means of any untrue statement of a material fact or any omission 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." 15 U.S.C. § 77q(a)(2).

"An omission or misstatement is material if a substantial likelihood exists that a reasonable investor would find the omitted or misstated fact significant in deciding whether to buy or sell a security, and on what terms to buy or sell." *Rowe v. Maremont Corp.*, 850 F.2d 1226, 1233 (7th Cir. 1988). Proof of scienter is required for Section 10(b) and Rule 10b-5(b), whereas negligence is sufficient for Section 17(a)(2). *Aaron*, 446 U.S. at 691, 697.

As described above, in connection with the purchase, sale, and offer of securities, Mueller and Northridge made false and misleading statements to investors, and they and the other Defendants obtained money or property by means of those statements. Mueller touted the profitability of his business, while failing to disclose Defendants' true financial condition and operation of a Ponzi scheme. The misstatements and omissions were unquestionably material. A reasonable investor would want to know that his or her funds, rather than being deployed to purchase or renovate real estate, would be used to repay other investors and for activities unrelated to real estate, including stock and options trading. *See, e.g., SEC v. Research Automation Corp.*, 585 F.2d 31, 35-36 (2d Cir. 1978) (misleading statements and omissions concerning the use of money raised from investors were material as matter of law); *SEC v. Better Life Club of Am.*, 995 F. Supp. 167, 177 (D.D.C. 1998) (it was "obvious" that misrepresentations by operator of pyramid scheme were material, where "no rational investor would knowingly invest in a project which never funded profitable ventures and which diverted substantial funds to the personal use of its promoters").

The submitted investor declarations bear this out. (*See* Ex. F, Smith Decl., ¶ 14 ("if I knew or had any reason to believe that Northridge did not have sufficient income from its operations or properties to cover capital costs and operating expenses, and that Northridge consistently needed new investor money to pay existing investors, I would not have invested in Northridge"); Ex. E, Petroff Decl., ¶ 9 ("If I had known that any portion of my investment would be used . . . for business or legal expenses unrelated to the garden-style apartments, or to make required payments to other Northridge investors, it would have made a difference to me in deciding whether I should invest or not."); Ex. G, Wilder Decl., ¶ 11 ("I would not have invested with Northridge if I knew that noteholder investment funds would be used to pay principal or interest owed to other Northridge investors, given to Mueller's family members . . . "); Ex. B, Stefan Decl., ¶ 16 ("If I had known that interest payments were being made from any other source [other than cash flows being generated from Timber Lake Apartments], I likely would not have invested."); Ex. D, McGarry Decl., ¶ 13 ("If I had known that the investment went to pay anything other than the maintenance or upgrading of properties, it would have been important to the investment decision.").)

Mueller knew that his statements to investors regarding the safety of investments, Northridge's financial condition, and the use of investor funds were false and misleading. Mueller controlled all of the Defendant Entities' finances, including how investor funds were used, and was the primary communicator with investors. Again, Mueller's scienter is imputed to the Defendant Entities, which he controlled.

C. This Court Should Draw an Adverse Inference from Mueller's Assertion of the Fifth Amendment.

If there is another side to the story, Mueller has refused to tell it. In response to the SEC's subpoena for testimony on June 4, 2019, Mueller refused to answer any questions and asserted his right against self-incrimination under the Fifth Amendment. This Court can and should draw an adverse inference against Mueller. *See Baxter v. Palmigiano*, 425 U.S. 308, 318-19 (1976); *Hillman v. City of Chicago*, 834 F.3d 787, 793 (7th Cir. 2016); *LaSalle Bank Lake View v. Seguban*, 54 F.3d 387, 390 (7th Cir. 1995) ("The rule that adverse inferences may be drawn from Fifth Amendment silence in civil proceedings has been widely recognized by the circuit court of appeals, including our own."); *SEC v. Smart*, 2011 WL 2297659, at *18 (D. Utah June 8, 2011) ("[T]he Commission is entitled to an adverse inference against Smart because the undisputed evidence demonstrates that Smart was the sole person responsible for the scheme to defraud investors by making material misrepresentations regarding how their money would be used, and because Smart asserted his Fifth Amendment privilege refusing to answer questions regarding the scheme.").

D. Absent Injunctive Relief, Defendants' Violations Will Continue.

Having established predicate violations of the federal securities laws, to obtain an injunction the SEC "need only show that there is a reasonable likelihood of future violations." *Holschuh*, 694 F.2d at 144. Here, each of the *Holschuh* factors used to assess that likelihood supports the imposition of a TRO and preliminary injunction against violations of Sections 5 and 17 of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

The Defendants engaged in a multi-faceted offering fraud for years on end with substantial consequences. Over 300 investors – many of whom used IRA funds – entrusted

Defendants with over $40 million, in unregistered transactions and based on false pretenses. As discussed above, Defendants acted with a high degree of scienter. And rather than recognize their own culpability or provide meaningful assurances against future violations, Defendants continued their unlawful scheme in the face of the SEC's investigation. In March and April 2019, Northridge issued securities totaling approximately $712,000.00 and continued to pay finders through at least August 6, 2019. (*Id.*, Ex. 4 (pages 8 and 15 of 16); ¶ 27.) Given Defendants' precarious finances, and their customary method of resolving negative cash flow, it is highly likely that Defendants will continue to seek capital from investors in order to meet their considerable debt obligations.[5]

Thus, the SEC also seeks a TRO and preliminary injunction enjoining Defendants from soliciting new investors (either directly or indirectly through finders), selling (including rolling-over) securities, and accepting additional funds from investors. In similar SEC enforcement actions involving offering frauds, courts have entered conduct-based injunctions similar to the one the SEC is requesting here. *See*, *e.g., SEC v. Equitybuild, Inc., et al.*, Case No. 18-cv-05587, Docket No. 15 (N.D. Ill. Aug. 17, 2018) (preliminarily enjoining defendants from directly or indirectly, soliciting any new investors or accepting additional funds from existing investors); *SEC v. Veros Partners,* Case No. 15-cv-659, Docket No. 12 (S.D. Ind. Apr. 23, 2015); *SEC v. Borland*, Case No. 18-cv-4352, Docket No. 7 (S.D.N.Y. May 16, 2018); *SEC v. Liu*, 2016 WL 3679389, *2 (C.D. Cal. July 11, 2016).[6]

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[5] On June 11, 2019, the bank account of Mueller Painting received a $145,000 wire from one of Northridge's largest investors, who also previously loaned Mueller approximately $1.8 million. (Saylor Decl., ¶ 38, n. 5.)

[6] These orders are attached as Exhibit H.

In addition, in June 2019, state securities regulators in Illinois, Massachusetts, New Hampshire, and New Jersey filed actions against Mueller, Northridge, and many of the other Defendant Entities for state registration violations, seeking cease-and-desist orders or permanent injunctions and financial penalties. These state actions do not cover investors in 28 other states who purchased promissory notes from the Defendants. These actions also do not allege fraud against the Defendants and do not seek the same relief as the SEC, including the appointment of a receiver.

II. This Court Should Appoint a Receiver and Grant Other Ancillary Relief.

This Court should grant ancillary relief to preserve the status quo, prevent future wrongdoing, and increase the likelihood of a recovery for the victims. The SEC respectfully requests: (1) appointment of a receiver; (2) an asset freeze; (3) an accounting; (4) a document preservation directive; and (5) expedited discovery.

A. The Standard for Ancillary Relief Is Permissive.

District courts enjoy considerable power to award ancillary relief, above and beyond issuing an injunction. "District courts possess broad equitable powers to grant 'ancillary relief . . . where necessary and proper to effectuate the purposes of' the securities laws." *SEC v. Am. Bd. of Trade, Inc.*, 830 F.2d 431, 438 (2d Cir. 1987) (citing *SEC v. Materia*, 745 F.2d 197, 200 (2d Cir. 1984)). "Federal courts have inherent equitable authority to issue a variety of ancillary relief measures in actions brought by the SEC to enforce the federal securities laws." *SEC v. Wencke*, 622 F.2d 1363, 1371 (9th Cir. 1980) ("The Supreme Court has repeatedly emphasized the broad equitable powers of the federal courts to shape equitable remedies to the necessities of particular cases, especially where a federal agency seeks enforcement in the public interest.").

The SEC's burden for emergency ancillary relief is the same – if not lower – than what it must prove for a TRO. *See SEC v. Cavanagh*, 155 F.3d 129, 132 (2d Cir. 1998) (ancillary relief requires "a lesser showing" than for injunctive relief); *SEC v. Compania Internacional Financiera S.A.*, 2011 WL 3251813, at *11 (S.D.N.Y. July 29, 2011) ("[A]n ancillary remedy may be granted, even in circumstances where the elements required to support a traditional SEC injunction have not been established.") (citation omitted). Specifically, the SEC establishes that ancillary relief is warranted by providing some basis for inferring a violation of the federal securities laws. *See, e.g.*, *Smith v. SEC*, 653 F.3d 121, 128 (2d Cir. 2011) ("Where an asset freeze is involved, the SEC 'must show either a likelihood of success of the merits, or that an inference can be drawn that the party has violated the federal securities laws.'") (citation omitted).

B. A Receiver is Necessary and Appropriate.

The Court should appoint a receiver over the Defendant Entities. Courts regularly appoint receivers to manage corporate assets when there has been fraud and mismanagement and a receiver is necessary to identify, marshal, preserve, and protect the assets. *See, e.g., SEC v. Enter. Trust Co.*, 559 F.3d 649, 650 (7th Cir. 2009); *SEC v. Homa*, 514 F.3d 661, 665 (7th Cir. 2008); *Equitybuild, Inc.,* Docket No. 15; *SEC v. Hollinger Int'l, Inc.*, 2004 WL 1125904, *7 (N.D. Ill. May 19, 2004). As the Seventh Circuit held in affirming a receiver's appointment:

> The prima facie showing of fraud and mismanagement, absent insolvency, is enough to call into play the equitable powers of the court. It is hardly conceivable that the trial court should have permitted those who were enjoined from fraudulent misconduct to continue in control of [the corporate defendant's] affairs for the benefit of those shown to have been defrauded. In such cases the appointment of a trustee-receiver becomes a necessary implementation of injunctive relief.

SEC v. Keller Corp., 323 F.2d 397, 403 (7th Cir. 1963).

This case calls out for the appointment of a receiver. Defendants raised at least $41.6 million by defrauding investors in a real estate investment scheme. A receiver is necessary to marshal and preserve assets to allow for the maximum possible recovery for investors. The SEC believes that significant assets exist that could be used to satisfy Defendants' disgorgement obligations and fund an eventual distribution to investors, most notably the portfolio of real estate that Northridge and Mueller described as "backing" or "securing" the promissory notes. In light of their misconduct, Defendants cannot be trusted to continue to manage these properties or to liquidate them or other assets for their victims' benefit. The timely appointment of a receiver is necessary to secure Defendants' assets to ensure the maximum recovery for harmed investors.

The SEC recommends the Court appoint Neville Reid as receiver in this matter. Mr. Reid is a partner at Fox Swibel, a Chicago-based business law firm. He is the co-chair of the firm's Bankruptcy, Restructuring and Creditors' Rights Group and has been a bankruptcy panel trustee in the Northern District of Illinois for over 23 years. Mr. Reid has experience investigating and recovering fraudulent transfers and various assets for the benefit of creditors of corporate entities and individual debtors. Mr. Reid and his firm have the relevant real estate experience to marshal the real estate assets in this case. Mr. Reid will engage the services of his law firm, which is willing to provide services at reduced rates.

To enable the receiver and the receiver's duly authorized agents to exercise their powers, duties or authority under any order of this Court, and to preserve the exclusive jurisdiction of this Court over receivership assets, the SEC seeks a stay of all ancillary civil legal proceedings, which, among other things, would bar any person or entity, other than the receiver, from placing any of the Defendant Entities or their affiliates in bankruptcy proceedings. *See, e.g., SEC v. Huber*, 702 F.3d 903, 908 (7th Cir. 2012) (recognizing "authority for allowing a district court, at the behest of the SEC when it is a party to a suit . . . to enjoin investors and other creditors from filing a bankruptcy action if that would interfere with the SEC's pursuit of equitable remedies"); *SEC v. Wencke*, 622 F.2d 1363, 1369 (9th Cir. 1980) (affirming issuance of stay against nonparty from initiating litigation against entity in receivership and finding stay was within court's equitable powers); *SEC v. Wealth Mgmt., LLC*, 2009 WL 3269665, at *1 (E.D. Wis. Oct. 8, 2009) ("In this case, just as in a bankruptcy matter, a stay of ancillary litigation is necessary to permit an orderly and efficient liquidation and distribution of the estate for the benefit of all creditors and investors.").

C. An Asset Freeze is Necessary and Appropriate.

This Court should impose an asset freeze over Defendant Mueller's personal assets,[7] and thus preserve any remaining funds for investors. To obtain an asset freeze, the SEC need only establish that it is likely to succeed on the merits of its claims. *FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1031 (7th Cir. 1988) (affirming district court's decision to impose an asset freeze and finding that the "district court had determined that it was probably that the FTC would prevail in a final determination on the merits"). As discussed above, the SEC has demonstrated both that Defendants have violated the federal securities laws and are likely to continue doing so should the Court not intervene.

[7] In the event that the Court does not appoint a receiver, the SEC requests that the asset freeze apply to all Defendants' assets.

Asset freeze orders are justified when the Court finds sufficient evidence of a threat that a defendant will dissipate assets. *Id.*[8] Here, Mueller has shifted millions of dollars from the Defendant Entities to Amberwood (his family limited partnership), brokerage accounts he controls, and to family members. (Saylor Decl., ¶¶ 52-83.) A freeze over Defendant Mueller's personal assets (in addition to the receivership order) is necessary to prevent the dissipation of assets that could be used to compensate harmed investors.

D. An Accounting of Assets is Necessary and Appropriate.

The equitable remedy of a sworn accounting is frequently imposed to provide an accurate measure of unjust enrichment and Defendants' current financial resources. *See*, *e.g.*, *Equitybuild, Inc.,* Docket No. 15; *Glick,* Docket No. 18. A prompt and complete accounting will assist in determining what assets remain and where they are located. Thus, an accounting remedy is needed here to determine the disposition of funds that Defendants misappropriated through their fraudulent conduct and the assets available to satisfy any final judgment the Court might enter against each Defendant.

E. A Document Preservation Order and Expedited Discovery Are Necessary and Appropriate.

Finally, the SEC seeks an order preventing the alteration or destruction of documents and other potential evidence. Mueller has already attempted to alter records in June 2019, when he asked his accountant at the time to "clean things up," because the Defendant Entities' internal

[8] At the TRO stage, courts have regularly imposed asset freezes. *See, e.g., SEC v. Equitybuild, Inc., et al.*, No. 18-cv-05587, Docket No. 15 (N.D. Ill. Aug. 17, 2018); *SEC v. Davis*, Case No. 17-cv-9224, Docket No. 13 (N.D. Ill. Dec. 22, 2017); *SEC v. Glick, et al.*, No. 17-cv-02251, Docket No. 18 (N.D. Ill. Apr. 6, 2017); *SEC v. Rungruangnavarat*, Case No. 13-cv-4172, Docket No. 9 (N.D. Ill. June 5, 2013) (orders attached as Exhibits H, I.)

financial records were inaccurate. (Saylor Decl., ¶ 78.) A document preservation order would protect the integrity of the proceeding and promote the truth-seeking function of litigation. *See, e.g.*, *Glick,* Docket No. 18 (granting motion prohibiting the destruction and requiring the preservation of documents); *SEC v. Rungruangnavarat*, Case No. 13-cv-4172, Docket No. 9 (N.D. Ill. June 5, 2013) (same).

The Court should likewise authorize expedited discovery under Fed. R. Civ. P. 30(a), 33(a) and 34(b), to allow the SEC to supplement its motion for a preliminary injunction. *See Rungruangnavarat*, Docket No. 9, at 7; *Equitybuild, Inc.,* Docket No. 15, at 7. Expedited discovery enables the SEC to act quickly to obtain bank and other records necessary to identify and preserve investor assets. Expedited discovery will also facilitate the presentation of a more complete evidentiary record and sharpen and focus the issues that must be decided by the Court at the preliminary injunction hearing.

CONCLUSION

For the above reasons, the SEC respectfully requests that the Court issue the relief requested in the proposed orders attached as Exhibits 1 and 2 to the SEC's motion, and grant such other ancillary relief as the Court deems just and proper.

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Respectfully Submitted,

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