

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76287 / October 28, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4246 / October 28, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31883 / October 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16932

In the Matter of

Gary M. Arford,

Respondent

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS, PURSUANT TO
SECTION 15(b) OF THE SECURITIES
EXCHANGE ACT OF 1934, SECTIONS
203(f) AND 203(k) OF THE INVESTMENT
ADVISERS ACT OF 1940, AND SECTION
9(b) OF THE INVESTMENT COMPANY
ACT OF 1940, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS AND
A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 (“Exchange Act”), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”), and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against Gary M. Arford (“Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents

to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds¹ that:

Summary

1. Between approximately December 2010 and October 2013, Respondent acted as an investment adviser to a private fund (the “Fund”), providing advice primarily with respect to real estate-related investments. While serving in that role, he defrauded the Fund and its investors in at least four ways. First, he induced the Fund to commit a total of \$4 million to an investment in a company that was purportedly planning to build and operate a hotel on undeveloped land in a Seattle suburb by misrepresenting and concealing material facts about the company’s debt and the encumbrances on its undeveloped property. Second, after obtaining the Fund’s investment commitment, Respondent took personal ownership of the company’s undeveloped property, and then pledged it as collateral for personal debts. Third, Respondent induced the Fund to continue fulfilling its investment commitment by concealing his personal ownership and use of the company’s undeveloped property and by misrepresenting and hiding material facts about the use of Fund assets and the status of the project. And finally, Respondent misappropriated Fund assets for purposes unrelated to the Fund’s intended investment. In so doing, Respondent violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8(a)(2) thereunder.

Respondent

2. Gary M. Arford, age 60, is a resident of Edmonds, Washington. Beginning in December 2010 and continuing throughout the relevant period, he personally acted as a “sub-adviser” to the Fund. As such, he received compensation from the Fund to provide advice concerning certain investments, particularly real estate-related investments. During the period at issue, Respondent also was the president of an SEC-registered investment adviser, which he founded, and was a registered representative associated with two SEC-registered broker-dealers.

Other Relevant Parties

3. “The Fund” is a private fund organized as a Colorado limited liability company and managed by another Colorado LLC, which, in turn, is controlled by an individual referred to herein as the “Fund Principal.”

¹ The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4. “Suburban Hotel” refers to a Washington limited liability company established in 2007 for the purpose of building and operating a hotel on an undeveloped parcel in a suburb of Seattle, Washington. Respondent was one of Suburban Hotel’s original investors.

5. “City Hotel” refers to a Washington limited liability company established in 2007 for the purpose of building and operating a hotel on an undeveloped parcel within the city limits of Seattle, Washington. Respondent was also an early investor in City Hotel.

Facts

A. Respondent Acted as an Investment Adviser to the Fund

6. As part of discussions about the formation of the Fund in around December 2010, Respondent and the Fund Principal agreed that Respondent would personally serve as “sub-adviser” to the Fund, and, as such, would advise the Fund as to certain investments, particularly real estate opportunities.

7. The Fund Principal and Respondent also agreed that Respondent would receive one-half of the management and performance fees paid by the Fund. All told, the Fund paid Respondent approximately \$226,700 in advisory fees.

8. Respondent, for compensation, engaged in the business of furnishing investment advice about securities to the Fund and, accordingly, was an investment adviser under Section 202(a)(11) of the Advisers Act.

B. Respondent Induced the Fund to Invest in Suburban Hotel by Misleading the Fund about Suburban Hotel’s Debts and the Encumbrances on its Property

9. At the time of the Fund’s formation, Respondent was an investor in both Suburban Hotel and City Hotel, and he recommended that the Fund consider investing in one or both projects. In early 2011, the Fund Principal visited both sites, and after conferring with Respondent, agreed that the Fund should invest in Suburban Hotel, but not in City Hotel.

10. By early March 2011, Respondent had increased his stake in Suburban Hotel to 88% and had assumed effective control over the project. Days later, following additional communications with the Fund Principal, Respondent secured a formal written commitment from the Fund to invest a total of \$4 million in Suburban Hotel. In return, Respondent, on behalf of himself and Suburban Hotel agreed: (1) to transfer to the Fund a 24% “preferred” interest in Suburban Hotel; and (2) to assign to the Fund the original bank note and deed of trust on the Suburban Hotel property (the “Suburban Property”), both of which Respondent had personally acquired through a transaction with the original lender in December 2010.

11. The Fund made its first payment under the agreement on March 15, 2011 and continued to make periodic deposits to Suburban Hotel until it fulfilled the \$4 million investment commitment in April 2013.

12. In communications with the Fund Principal about the Fund’s potential investment in Suburban Hotel, Respondent assured the Fund Principal that the Fund’s investment ultimately

would pay off a single outstanding loan, leaving the Suburban Property “free and clear.” Therefore, Respondent represented, even if the project never broke ground, he would be able to generate a profit for the Fund and himself simply by selling the Suburban Property, which Respondent represented had appraised for substantially more than the Fund had committed to invest. In one email, for example, Respondent wrote, “[w]orst case scenario is that we have to pay off the property This is now as low risk as anything I have ever been involved with.”

13. In fact, Respondent knew, but concealed from the Fund, that Suburban Hotel was in *default* on an approximately \$1.25 million loan from a construction and financing firm (the “Construction Lender”). Moreover, that debt, which Respondent had personally guaranteed, was growing each day with unpaid interest and fees and was secured by a deed of trust on the Suburban Property. Hence, contrary to Respondent’s assurances to the Fund Principal, repayment of the single loan that Respondent *did* disclose would not necessarily leave the Suburban Property “free and clear.” Rather, so long as the debt owed to Construction Lender remained unpaid (which it did), Suburban Hotel would be unable to sell the property without repaying that debt.

C. *In an Effort to Rescue the City Hotel Project, Respondent Took Personal Ownership of the Suburban Property, and then Pledged it as Collateral for Personal Debts*

14. In the spring of 2012, Respondent’s other hotel project, *City Hotel*, was on the verge of financial collapse. *City Hotel* was in default on its bank loan (repayment of which Respondent had personally guaranteed), the outstanding loan balance (with unpaid interest and fees) stood at approximately \$3.4 million, and the bank (the “City Hotel Lender”) had scheduled a foreclosure sale of *City Hotel*’s undeveloped land (the “City Property”).

15. In late May 2012, in an effort to prevent foreclosure on the City Property, Respondent reached an agreement with City Hotel Lender under which they agreed that: Respondent would make a partial loan payment of \$1.85 million to City Hotel Lender in exchange for the bank postponing the foreclosure sale; the bank would assign its rights to Respondent if he paid the remaining loan balance (approximately \$1.4 million) before August 24, 2012; but the bank would have the right to proceed with foreclosure if Respondent failed to pay off the balance by the August deadline.

16. To obtain financing for his first payment to City Hotel Lender, Respondent caused *Suburban Hotel* to convey the Suburban Property to him in his personal capacity, leaving *Suburban Hotel* with no assets other than cash supplied by the Fund. Then, in June 2012, Respondent pledged the Suburban Property as collateral for a \$2.4 million loan from a hard money lender (“Hard Money Lender”), the net proceeds of which he used to make his \$1.85 million down payment to City Hotel Lender, leaving a balance of approximately \$1.4 million on the City Hotel loan.

17. At the same time, Respondent gave a new second-position deed of trust on the Suburban Property to *Construction Lender* as collateral for a confession of judgment, which Construction Lender required him to sign in exchange for allowing Hard Money Lender to take a priority position on the Suburban Property.

18. In short, having induced the Fund to invest in Suburban Hotel, Respondent conveyed Suburban Hotel's only asset to himself, and then used it to secure personal debts to Hard Money Lender and Construction Lender, all in an effort to rescue the City Property – in which the Fund had no interest and in which the Fund Principal had specifically declined to invest – from foreclosure. Respondent disclosed none of these actions to the Fund.

D. *Respondent Used the Fund's Assets to Pay Off the City Hotel Loan and Acquire the City Property*

19. As of late July 2012, Respondent had not raised the roughly \$1.4 million still owed to City Hotel Lender, and a new foreclosure date for the City Property was pending.

20. On July 31, 2012, Respondent sent an email to the Fund Principal, telling him he needed \$1.4 million from the Fund for "development costs, plans, etc." associated with Suburban Hotel.

21. On August 10, 2012, per Respondent's request, the Fund wired \$1.4 million to Suburban Hotel's bank account, which Respondent controlled. The following business day, Respondent wired nearly all those funds to City Hotel Lender, thereby paying off the City Hotel loan, eliminating any liability he might otherwise have had on his personal guarantee of that loan, and acquiring the bank's rights under the original note and deed of trust on the City Property.

22. On August 16, 2012, Respondent personally acquired the City Property in a previously-scheduled foreclosure sale, using as his bid the payments he had already made to City Hotel Lender (including the \$1.39 million that had come from the Fund).

23. Respondent disclosed none of these actions to the Fund and, in fact, continued to request that the Fund make periodic deposits to Suburban Hotel in furtherance of the Fund's investment commitment to that company.

E. *Respondent Used Fund Assets to Make Settlement Payments to Construction Lender and Used Proceeds from the Sale of the Suburban Property to Pay Off Personal Debts*

24. The confession of judgment that Respondent signed with Construction Lender in June 2012 required a repayment of approximately \$1 million by late September 2012, with the remaining balance due by December 31, 2012. In February 2013, Construction Lender, having not received those required payments, filed Respondent's confession of judgment in Washington state court and obtained a formal judgment against him.

25. On or about March 18, 2013, Respondent and Construction Lender reached a settlement agreement concerning Respondent's debt. Under the agreement, Respondent promised: (1) to pay Construction Lender \$190,000 immediately; (2) to sell the Suburban Property (on which Respondent had signed a contract of sale but had not closed); (3) to pay Construction Lender \$1.2 million from the sales proceeds; and (4) to pay Construction Lender approximately \$260,000 thereafter.

26. On or about March 19, 2013, Respondent made his first \$190,000 settlement payment to Construction Lender, using funds that had been furnished by the Fund for Suburban

Hotel. On or about March 26, 2013, he sold the Suburban Property, paying most of the proceeds to Hard Money Lender (approximately \$2.4 million) and Construction Lender (\$1.2 million). Following the sale, Respondent used additional cash from the Fund to make his final settlement payments to Construction Lender.

27. In August 2013, approximately five months after the fact, Respondent disclosed to the Fund that he had sold the Suburban Property, but otherwise did not disclose the facts described in paragraphs 24 – 26 above.

F. *Respondent Misappropriated Fund Assets*

28. Throughout the relevant period, nearly all of the cash deposited into Suburban Hotel's bank account, which Respondent controlled, came from the Fund. As noted above, without disclosure to the Fund, Respondent used the Fund's cash to pay off the City Hotel loan and to make settlement payments to Construction Lender. In addition:

- a. Between April 2011 and October 2013, Respondent paid approximately \$382,000 to cover consulting fees, lending fees, and other expenses relating to the City Hotel project.
- b. In late 2012, Respondent used approximately \$10,700 to make loan advances to a personal friend.
- c. Between January and May 2013, Respondent wrote checks totaling \$380,000 to another entity that he controlled, and then used those funds for purposes unrelated to Suburban Hotel.
- d. In June and July 2013, Respondent used \$242,000 to cover payments related to a land development project in Steamboat Springs, Colorado.

29. Respondent induced the Fund to continue providing cash to finance these unauthorized payments by failing to disclose and affirmatively misrepresenting material facts. For example:

- a. During the second half of 2012, Respondent sought periodic cash infusions from the Fund without disclosing that he had transferred the Suburban Property to himself and had further encumbered it to secure his debt to Hard Money Lender on the City Hotel project and his confession of judgment to Construction Lender.
- b. In late 2012, Respondent sought additional cash from the Fund "to finish paying off the debt" and "go forward" with construction on the Suburban Property, even though he had already signed a contract to *sell* the property.
- c. In April 2013, Respondent requested that the Fund provide "the balance of the \$4 million" investment commitment to Suburban Hotel

without disclosing that he had sold the Suburban Property the previous month.

G. *The Current Status of the Fund's Investment*

30. In September 2013, Respondent advised the Fund Principal that he had unilaterally replaced the Fund's investment in Suburban Hotel with an equivalent investment in a new entity he had established as a vehicle for the *City* Hotel project. Development of the City Property did not proceed, however.

31. On or about May 15, 2015, the City of Seattle (the "City") filed an eminent domain proceeding with respect to the City Property in the Superior Court of Washington, King County (the "Superior Court"), foreclosing further development efforts.

32. In late July 2015, the City deposited \$7,300,000 into the registry of the Superior Court, pursuant to a stipulation among the parties to the eminent domain proceeding.

33. On or about July 31, 2015, the Superior Court ordered the release of approximately \$1.7 million from the funds deposited by the City to satisfy an outstanding mortgage secured by the City Property and taxes owed on the property.

34. On or about August 8, 2015, Respondent and the Fund entered into an agreement requiring Respondent, upon approval by the Superior Court, to make certain payments to the Fund from the funds on deposit with the Superior Court.

Violations

35. By virtue of the conduct described above, Respondent willfully violated Section 206(1) of the Advisers Act, which prohibits an investment adviser from employing any device, scheme, or artifice to defraud any client.

36. By virtue of the same conduct, Respondent willfully violated Section 206(2) of the Advisers Act, which prohibits an adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

37. By misappropriating Fund assets, Respondent also willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8(a)(2) thereunder, which prohibits an adviser to a pooled investment vehicle from engaging in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 15(b) of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

B. Respondent be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall pay disgorgement, prejudgment interest, and a civil penalty as follows:

1. Disgorgement and Prejudgment Interest

a. Respondent shall pay to the Securities and Exchange Commission disgorgement of \$4,226,684, together with prejudgment interest of \$21,256 (for a total of \$4,247,940), within 360 days of the entry of this Order; *provided* that any payment that Respondent makes to the Fund, and that is reflected by evidence acceptable to the Commission staff, will be credited, dollar-for-dollar, towards the satisfaction of Respondent's disgorgement and prejudgment interest obligations.

- b. The Commission will hold funds, if any, paid to the Commission pursuant to Respondent's disgorgement and prejudgment interest obligations in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or transfer them to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Exchange Act.

2. Civil Penalty

- a. Respondent shall pay a civil penalty of \$150,000 to the United States Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Exchange Act.
- b. Payment of the civil penalty shall be made in the following installments: \$20,000 within 10 days of the entry of this Order; \$30,000 within 90 days of the entry of this Order; and \$100,000 within 360 days of the entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or, as to any unpaid civil penalty, pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application.

Payment to the Commission must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Gary M. Arford as the Respondent in these proceedings and identifying the file number of these proceedings. A copy of the cover letter and check or money order must be sent to:

Kurt L. Gottschall
Assistant Regional Director, Asset Management Unit
Securities and Exchange Commission
1961 Stout Street, Suite 1700
Denver, CO 80294-1961.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary