

STATE OF NORTH DAKOTA
OFFICE OF SECURITIES COMMISSIONER

IN THE MATTER OF:)	
)	
Preferred Trust and Management, LTD, and Tony Kautt,)	FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER
)	
Respondents.)	
)	

On April 10, 2001, the Securities Commissioner issued a separate Cease and Desist Order, Notice of Civil Penalty, and Notice of Right to Request a Hearing to Tony Kautt ("Kautt"), along with a number of other individuals who had been involved in the sale of Preferred Trust and Management, LTD ("Preferred Trust"), securities in North Dakota. On August 21, 2001, the Securities Commissioner requested the designation of an administrative law judge ("ALJ") from the Office of Administrative Hearings ("OAH") to conduct a hearing and to issue recommended findings of fact and conclusions of law, and a recommended order in regard to some of these cases, including Kautt. Allen C. Hoberg, ALJ, was designated to preside as hearing officer for Kautt's case, which was consolidated with four others because the same attorney, Tom P. Slorby of Minot, represented those respondents. All parties agreed to consolidation.

Proceedings in the case were stayed pending the appeal on a related matter before the Commissioner to the District and Supreme Court. Henry, et al v. Commissioner, 2003 ND 62, 659 N.W.2d 869. On April 15, 2003, the Supreme Court issued its decision in Henry, dismissing the appeal because the Commissioner's July 31, 2001, Order was not a final order. Id.

On May 8, 2003, the ALJ issued a Notice of Consolidated Hearing for Kautt and those other respondents consolidated with his case. The hearing was scheduled for July 21, 2003. The hearing was held as scheduled on July 21, 2003, in the Office of Administrative Hearings, Bismarck, North Dakota. Special Assistant Attorney General Matthew O. Bahrenburg represented the Securities Commissioner. Kautt, along with other respondents, was present and was represented at the hearing by Mr. Slorby.

The Securities Commissioner called as witnesses its investigator and examiner, Kelly Mathias, the respondents, and several other witnesses. During the course of his testimony, Mr. Mathias was qualified as and declared an expert on high yield investment fraud and prime bank fraud. The Commissioner offered many exhibits. The respondents offered one exhibit. Two exhibits offered were withdrawn, exhibits W-3 and W-4. Exhibits E, G-Q, R and F were conditionally admitted over objection by respondents. The rest of the exhibits were admitted.

On July 23, 2003, the Commissioner filed a letter brief on the evidentiary matter. On August 12, 2003, the Commissioner filed the Commissioner's "Post-Hearing Brief and Closing Argument." On August 29, 2003, the respondents filed their letter brief which addressed only the evidentiary matter of the conditional exhibits. On September 11, 2003, the ALJ received the Commissioner's email correspondence stating that no reply brief would be filed. Accordingly, the record in this matter was closed on September 11, 2003.

On September 25, 2003, the ALJ issued Recommended Findings of Fact, Conclusions of Law and Order. The ALJ found that Preferred Trust was a fraudulent investment scheme. The ALJ found that the Preferred Trust investment scheme is a

security as defined in N.D.C.C. § 10-04-02(15). The ALJ found that the scheme was not registered as a security in North Dakota and is not exempt from registration under the Securities Act. The ALJ found that the respondents included in the consolidated hearing, including Kautt, were not at that time and had never been registered as securities investment advisor representatives or securities agents in North Dakota.

The ALJ found that the documents supporting the actions of the respondents in violation of the securities laws were not admissible and, therefore, found that there was no evidence showing an offer or sale of any security by any of the respondents in the consolidated hearing, including Kautt.

As discussed below, the Commissioner adopts in part and rejects in part the ALJ's recommendations and, in lieu thereof, issues this final order in the matter of Kautt.

Admissibility of the Evidence

The ALJ originally admitted over objection as hearsay Exhibits E, G-Q, R and F. Exhibits E, G-Q, R and F are documents seized from and found on the computer of Frederick Keiser, a commodities broker in Minot who acted as a principal for the Preferred Trust investment scheme in North Dakota. These documents were offered through Kelly Mathias, who qualified as an expert on high yield investment fraud and prime bank fraud. A trial deposition and trial transcripts from the trial of Fred Keiser for his actions in the Preferred Trust scheme were offered and received. The transcripts identified how the documents came to be in Mr. Mathias' possession. See Exhibits S, T, U. They, along with Mr. Mathias' testimony, show that Mr. Mathias was in attendance at the original search in which the computer was removed from Mr. Keiser's office, that the computer was taken into the possession of a Bureau of Criminal Investigation agent,

that the computer was transferred to the Mid-States Organized Crime Information Center where true and accurate copies of the documents on the computer were retrieved onto a compact disc, and that the compact disc was returned to the North Dakota Bureau of Criminal Investigation and provided to the Securities Department. There was no evidence introduced that undermined the authenticity of the documents taken from Mr. Keiser's computer.

However, the ALJ "struck" the admission of those exhibits as to the respondents in the consolidated hearing on the grounds that there was no testimony that identified the documents as business records of either the present respondents or of the absent respondent, Preferred Trust. The ALJ indicated that no witness was familiar with the offered exhibits and none had specific knowledge about the procedures under which the records were created. Finally, the ALJ claimed that there was no evidence about what these records mean in the business context, if anything, for Preferred Trust. In complete contradiction to these statements, the ALJ then identified that Mr. Mathias was able to testify about them as business records and could interpret them and could even make an apparently relevant summary about them.

The ALJ also identified that Mr. Mathis and many of the witnesses recognized the Keiser business records as part of the Preferred Trust investment scheme, a fraudulent investment scheme in which the respondents participated. Because the investment scheme was fraudulent, however, the ALJ claimed that these were not ordinary business records or subject to interpretation as common business records. The ALJ's explanation of this ground for rejecting the records is just not logical. Merely because a business is fraudulent does not mean that the records kept by the business are not

accurate records of the transactions that were conducted in the course of operating the business. With the exception of one case, none of the records on Mr. Keiser's computer regarding the transactions of the respondents in the consolidated hearing were shown to be inaccurate.

Further, the ALJ, in the course of three separate proceedings involving similar respondents and Preferred Trust, treated the introduction and use of these records differently as to the different respondents. The Commissioner finds this unacceptable. In the hearing for Respondents Dennis Skarphol, Gerald Henry and Brian Henry, the ALJ admitted the same now-excluded exhibits, finding that the documents "showed that the three respondents were entitled to compensation from securities referrals, and monies were possibly earmarked for them."¹ In the separate hearings for Respondents Larry Borud and Mark Dostert, the ALJ struck the same exhibits relating to information taken from Fred Keiser's computer as to those respondents, and then extensively cited and relied upon those excluded exhibits to support his findings that Borud and Dostert had violated the securities laws. The Commissioner is unwilling to have the same evidence offered as to the various respondents treated in such an inconsistent manner. Under these similar circumstances, either they are admissible or they are not. The Commissioner finds they are admissible, as follows.

The Commissioner finds that the documents taken from Keiser's computer concerning the Preferred Trust accounts are admissible as to all respondents who were involved in the referral of potential purchasers to the Preferred Trust website and who,

¹ The ALJ did not believe this evidence showed that an actual offer or sale had been proven, a finding with which the Commissioner takes issue.

as a result of the referrals, were eligible to receive the equivalent of commissions for the subsequent sale of Preferred Trust shares, including Kautt. Keiser acted as an agent for Preferred Trust and maintained records of those individuals in North Dakota who had made referrals to Preferred Trust, including Kautt. Preferred Trust is a co-respondent with Kautt. Kautt referred one or more individuals to Keiser to invest in the Preferred Trust scheme. Mr. Mathias, who qualified as an expert on high yield investment fraud and prime bank fraud, was able to identify what the records meant and how they were kept in the ordinary course of Keiser's business on behalf of the fraudulent Preferred Trust investment scheme. The documents from Keiser's computer are equally relevant as to Preferred Trust and to Kautt. Finally, testimony of witnesses confirmed that the records are accurate as to the referrals Kautt made to Preferred Trust through Keiser for investment in Preferred Trust. Mr. Mathias laid sufficient foundation for the introduction of these records and, although hearsay, they have substantial guarantees of trustworthiness through Mr. Mathias' explanations of their meaning and the confirmation of that meaning through the testimony of the respondents in the consolidated hearing.

For these reasons, the Commissioner rejects the ALJ ruling that Exhibits E, G-Q, R and F are not admissible in this hearing as to Kautt.

The ALJ's Evaluation of the Evidence

The ALJ included a discussion of his personal "Evaluation of the Evidence." Essentially, this appears to be an effort by the ALJ to buttress his recommended findings of fact and conclusions of law by a "personal" statement of his view of the credibility of the respondents' statements and his view of the "investment scheme" as related to these respondents. While the Commissioner agrees that these individuals

are also "victims" because they lost their own money on a scheme that was fraudulent, the Commissioner also finds that the various respondents, including Kautt, referred others to this investment scheme because of a desire to receive bonuses, in the nature of commissions, based on a percentage of the invested amount.² In this regard, the Commissioner believes the evidence shows Kautt discussed this investment with others and recommended they look at Preferred Trust as an investment and, as a result of these referrals, Kautt knew that he would receive a bonus if the individual invested in Preferred Trust. The Commissioner listened to the same evidence listened to by the ALJ and takes exception with the ALJ's evaluation of the evidence and inferences to be drawn from the evidence, finding the ALJ's evaluation of the evidence unsubstantiated by the totality of the evidence.

Additional documents were admitted by the ALJ through Mr. Mathias' testimony that identified how the Preferred Trust scheme operated. These documents were printed from the Preferred Trust website. Mr. Mathias' testimony was accepted to prove that the Preferred Trust scheme was a prime bank fraud. Based on his understanding of the fraudulent scheme and the information on the website about the referrals and bonuses, Mr. Mathias was able to explain how each individual who "referred" someone else to the website would be paid for his referral. Finally, Mr. Mathias, based on his knowledge of the operation of the Preferred Trust scheme and his review of Mr. Keiser's documents, was able to tie Kautt to an account number and to referrals Kautt made to

² The Commissioner believes the "bonuses," based on a percentage of the referred party's initial investment, are similar to a commission or finder's fee, however, in the interests of continuity, this Order will continue to refer to them as "bonuses" as that is the nomenclature used by Preferred Trust and used in the evidentiary hearings.

the Preferred Trust website or to Keiser. There was no evidence that disputed Mr. Mathias' expert testimony as to how the Preferred Trust scheme operated or how the bonuses were calculated for Kautt's referrals to Preferred Trust.

For these reasons and based on the testimony and evidence, the Commissioner finds that Kautt took action and had knowledge, as follows.

Kautt testified that he invested \$87,000 of his own money in Preferred Trust. Kautt went to Keiser to make his investment. Keiser discussed Preferred Trust with him and printed pages from the Preferred Trust web page for Kautt to review. Subsequently, Kautt sent others to Keiser to invest in Preferred Trust.

According to the testimony of Clarence Folden, Kautt told him and Thomas Miller about Preferred Trust, and, in fact, when Clarence suggested that he thought it sounded a little risky, Kautt reiterated that he thought it was a pretty good investment. Folden testified that Kautt convinced a group of three or four patrons of Folden's bar to invest in Preferred Trust. Folden and Miller then went to Keiser and invested in Preferred Trust under Miller's name. After their visit to Keiser, they were listed in Keiser's records through Miller's name as having been referred by Kautt. A credible inference is that either Kautt told Keiser that he was referring these two individuals to him, or these two individuals told Keiser that Kautt had referred them to him to invest in Preferred Trust. See N.D.C.C. § 31-11-03(20) (establishing a rebuttable presumption "[t]hat the ordinary course of business has been followed").

Nicholas Kautt also testified that he had invested in Preferred Trust. He testified that Kautt had told him about Preferred Trust and had introduced him to Keiser at Folden's bar. Nicholas Kautt then attended a meeting with Keiser and Kautt about

Preferred Trust. Keiser's records show that Kautt was the referral source for Nicholas Kautt. As noted above, a credible inference is that either Nicholas Kautt told Keiser that Kautt had referred him to Keiser and Preferred Trust or Kautt himself did.

Kautt testified that he discussed Preferred Trust with Brad Nesheim. He told Nesheim that he had invested through Keiser. Nesheim attended a meeting with Kautt and Keiser about investing in Preferred Trust. Nesheim subsequently invested in Preferred Trust. Kautt was given credit for referring Nesheim to Preferred Trust. Again, either Nesheim told Keiser that Kautt referred him to Keiser and Preferred Trust or Kautt himself did.

Kautt indicated that he received regular statements of his Preferred Trust accounts. On these statements it clearly indicates that he had deposits of funds that were attributed to "bonuses earned from introductions." See Exh. V-2. While Kautt attempted to suggest that he didn't know why he was getting the bonuses, this testimony is not credible.

Kautt had copies of the Preferred Trust web pages when he invested. See Exhs. A, B. Kautt was investing large sums of money – an amount identified as \$87,000 – in Preferred Trust. The only credible inference is that he read the material, at least the initial material, to determine how and what he could earn from his own investment. See N.D.C.C. § 31-11-03 (establishing a rebuttable presumption "[t]hat a person takes ordinary care of that person's own concerns"). That information is contained in two back-to-back parts of the "Policies and Procedures" portion of the investment information. See Exh. A, Policies and Procedures at 3. Those sections, "Offshore Investment Program," and "Bonuses," describe clearly how an investment in Preferred

Trust will return earnings, including a description of a "Business Builder Bonus" that clearly advises an investor that the investor "may earn monthly bonuses by introducing other investors." The information clearly identifies that the bonus is paid based on the amount the introduced party invests. Further, another section of the Preferred Trust information identifies, in a section referred to as "Frequently Asked Questions," that the Business Builders Bonus is the "only bonus paid on a monthly basis, and is *readily available for withdrawal from the Trust Account without any penalties.*" Exh. A, Frequently Asked Questions, page 4 of 4 (emphasis added).

Based on the totality of the evidence presented at the hearing, the Commissioner finds that Kautt had knowledge that he would earn a bonus for introductions he made to Preferred Trust and that he made certain introductions to Preferred Trust that earned him such bonuses. The evidence shows that Kautt introduced four individuals to Preferred Trust (two of whom invested jointly under one account name) for a total investment of \$27,000. This investment earned Kautt a 1% bonus of \$270. Further, the information provided by Preferred Trust shows that Kautt received the bonuses because the bonus money was in his Trust account and that it was available to him at any time.

Findings of Fact

1. The Securities Commissioner investigated the activities of Frederick W. Keiser ("Keiser") of Minot and seized a computer from him. As a result of that investigation, separate Cease and Desist orders were issued against Preferred Trust and, amongst others individuals, Kautt.

2. The information introduced directly from Keiser's computer or in summary form accurately reflects the records contained on Keiser's computer relevant to the account of Kautt as a Preferred Trust investor.

3. The information from Preferred Trust's website identifies to investors the nature of Preferred Trust's investments and that monthly bonuses will be paid for introductions of other investors. See Exh. A, Policies and Procedures at 3. The information clearly identifies that the bonus is paid based on the amount the introduced party invests.

4. The Preferred Trust's website identifies that the bonus is "paid on a monthly basis, and is *readily available for withdrawal from the Trust Account without any penalties.*" Exh. A, Frequently Asked Questions, page 4 of 4 (emphasis added).

5. Kautt knew that he would receive a bonus for each referral he made to Preferred Trust when the referral resulted in an investment.

6. Kautt referred at least four individuals to Preferred Trust and the referrals resulted in investments by the referred people.

7. Kautt discussed Preferred Trust with at least four other individuals and referred these individuals to Preferred Trust in North Dakota.

8. Kautt received one or more bonus payments for the referrals made to Preferred Trust where the referrals resulted in an investment by the referred people.

9. The bonus payment paid Kautt was deposited in a Trust Account and was available for withdrawal whenever Kautt chose to withdraw the funds by applying for and using a debit card.

10. Kautt was not, at any of the time relevant to the issues in this matter, registered as a securities investment advisor representative or securities agent in North Dakota.

Conclusions of Law

1. The Preferred Trust investment scheme is a security as defined in N.D.C.C. § 10-04-02(15) (1999).

2. Preferred Trust is not registered or exempt from registration in North Dakota. See N.D.C.C. § 10-04-05 (1999), N.D.C.C. § 10-04-07 (1999), N.D.C.C. § 10-04-07.1 (1999), N.D.C.C. § 10-04-08 (1999), N.D.C.C. § 10-04-08.1.

3. The Preferred Trust securities were not offered for sale or sold in an exempt transaction. See N.D.C.C. § 10-04-06 (1999).

4. The Preferred Trust investment scheme is a fraudulent investment scheme.

5. An "offer for sale" or "offer to sell" includes an attempt to solicit an order for a security for value. N.D.C.C. § 10-04-02(9) (1999). This language has been interpreted to and does include action that materially aids in a sales transaction of a security, including the solicitation of a buyer. See Pinter v. Dahl, 486 U.S. 622, 646-47 (1987). Other states have found such payments of finders fees, which would be equivalent to the referral bonuses paid in this case, to require registration as an agent by the person receiving the fee. See Blue Sky Law, Joseph C. Long, Vol. 12A, §8.33, © 2003. The federal Securities and Exchange Commission has stated that it would be a violation of the securities law for an individual who was not registered to make referrals to a broker and receive compensation for the referrals. See CCH ¶79,959 (1988).

6. Kautt's referral of at least four individuals to the Preferred Trust investment scheme with the knowledge that he would be entitled to compensation when those other people invested constituted an "attempt to offer to dispose of . . . a security or interest in a security for value," and therefore would be an "offer for sale" or "offer to sell." See N.D.C.C. § 10-04-02(9) (1999). When those people actually invested, the referrals became sales under N.D.C.C. § 10-04-02(13) (1999). Kautt acknowledged referring others to the scheme and identified that he was personally invested in the scheme. Kautt knew about the bonuses available for referrals. This is sufficient evidence to establish that Kautt was a seller within the meaning of the language of N.D.C.C. § 10-04-02 (1999). As such, Kautt violated the provisions of N.D.C.C. § 10-04-04 by offering a security for sale that was not registered in North Dakota.

7. The evidence shows that Kautt violated the provisions of N.D.C.C. § 10-04-10 (1999) requiring that an individual offering for sale or selling any securities in North Dakota must be registered as a dealer or agent. Kautt referred others to the scheme with the knowledge that he would be entitled to compensation if they invested. Those referrals constituted "an attempt to offer to dispose of . . . a security or interest in a security for value" and is, therefore, an "offer for sale" or "offer to sell" as defined in N.D.C.C. § 10-04-02(9) (1999). When Kautt referred others to Keiser for investment in the Preferred Trust scheme, he was offering to sell and selling to investors in North Dakota and was acting as an unregistered agent of the unregistered securities dealer Preferred Trust (through Fred Keiser). Thus, Kautt was in violation of N.D.C.C. § 10-04-10 (1999).

8. Kautt violated the provisions of N.D.C.C. § 10-04-15(2) and (4) by offering for sale investments in a fraudulent investment scheme. Any person who solicits investors to invest in a fraudulent program is engaging in a course of business that operates as a fraud or deception upon investors. There is no intent required under N.D.C.C. § 10-04-15(2) or (4). Preferred Trust is a fraudulent investment scheme. Kautt violated the provisions of N.D.C.C. § 10-04-15(2).

9. Under N.D.C.C. § 10-04-16 (1999), a \$10,000 civil penalty may be imposed for each violation of N.D.C.C. ch. 10-04.

10. As to Tony Kautt, the evidence shows four violations of N.D.C.C. § 10-04-04 (one violation for each investor Kautt referred to the Preferred Trust scheme). The evidence shows four violations of N.D.C.C. § 10-04-10 (one violation for each investor Kautt referred to the Referred Trust scheme). The evidence shows four violations of N.D.C.C. § 10-04-15 (one violation of the prohibition against fraudulent practices for each of the four frauds in which Kautt was engaged that were perpetrated upon those four investors). Therefore the Commissioner has authority to impose a civil penalty against Kautt in the amount of \$120,000.

Order

The greater weight of the evidence shows that Kautt violated the provisions of N.D.C.C. §§ 10-04-04, 10-04-10 (1999), and 10-04-15 and, therefore, it is ordered that the Cease and Desist Order issued against him on April 10, 2001, remain in effect, indefinitely, unless otherwise lifted or dismissed by the Securities Commissioner. Further, although a civil penalty may be imposed in the amount of \$120,000 against Kautt, the evidence shows that Kautt was, as many of the individuals who participated in

the furtherance of the Preferred Trust scheme, a victim as well as a perpetrator. It would be unfair to impose a very large civil penalty against any of them.

Therefore, it is ordered that a civil penalty is imposed against Kautt in the amount of \$4,000.

Dated at Bismarck, North Dakota, this ^{5th}5 day of March, 2004.



NORTH DAKOTA SECURITIES DEPARTMENT


Karen Tyler
Securities Commissioner