UNITED STATES OF AMERICA
Before the
CONSUMER FINANCIAL PROTECTION BUREAU

ADMINISTRATIVE PROCEEDING
File No. 2013-CFPB-0002

In the Matter of: **3D Resorts-Bluegrass, LLC**	**PREHEARING BRIEF OF THE CONSUMER FINANCIAL PROTECTION BUREAU**

The Consumer Financial Protection Bureau ("Bureau"), an independent agency of the United States government, was created to help protect consumers through the enforcement of federal consumer financial protection laws. Among the laws that the Bureau is charged with enforcing is the Interstate Land Sales Act ("ILSA"), 15 U.S.C. § 1701 *et seq.*, which was enacted to "protect purchasers from unscrupulous sales of undeveloped home sites." *Winter v. Hollingsworth Props., Inc.*, 777 F.2d 1444, 1447 (11th Cir. 1985).

The Bureau initiated this action because the respondent, 3D Resorts-Bluegrass, misled consumers in the purchase of property at the Green Farm Resort, and otherwise failed to comply with the requirements of ILSA. The hearing in this matter is scheduled to begin on August 14, 2013.

I. Overview of the Case

As set forth in the Notice of Charges, and as the evidence at the hearing will show, 3D Resorts-Bluegrass, LLC ("3D Resorts-Bluegrass") and its agents made misrepresentations in the property reports and in the marketing of Green Farm Resort property to consumers, in violation of ILSA and its implementing regulations. 3D Resorts-Bluegrass and its agents committed several other violations of ILSA related to registration and filing requirements, and by selling properties in violation of a Department of Housing and Urban Development ("HUD") suspension notice prohibiting such sales. Furthermore, these misrepresentations and other violations were material factors in consumers' decisions to purchase lots at prices greatly exceeding their value. As a result, consumers have received little, if any, value from these properties, most of which are completely unbuildable and have no prospects of development. At the same time, these purchasers still maintain mortgage obligations, sometimes in the amount of tens of thousands of dollars.

A. Summary of the Case

1. The Resort Property

The development at issue is a large property located in Grayson and Breckinridge Counties in the Commonwealth of Kentucky that is commonly referred to as the Green Farm Resort or The Falls Resort & Golf Club (the "Resort Property"). It is a golf/recreation facility with hundreds of individual lots spread over several different development phases. Lots are generally ¼ to ½ acre in size, and were marketed as lots on which purchasers could build vacation homes where they would enjoy the golf course and other amenities of the resort.

The property spans over 1,500 acres across two counties (Grayson and Breckinridge), 1,356 acres of which are vacant land. Located in Grayson County are the Falls of Rough Golf

Course, a regulation length course of approximately 243 acres (which is now closed), and the nine-bedroom Mansion Bed and Breakfast, which was converted and restored from a single family estate residence in 2001. Of the four phases of development (or "Sections"), three of the four lack potable water; three of the four lack electricity; and one lacks sewage. One section has only rough road cuts and gravel roadbeds, with platted lots unfit for septic installation and considered unbuildable. Other than ten kit-build cabins (of which three are only in "shell condition") there are only three houses on the property, although hundreds of lots have been sold. Several houses in three separate sections are located in a floodplain. Properties that once sold for $25,000 or $30,000 cannot claim even ten percent of that price today.

2. 3D Resorts-Bluegrass and the Development of the Property

3D Resorts-Bluegrass, along with 3D Resort Communities, LLC (its parent), Double Diamond, Inc. ("Double Diamond"), and National Resort Marketing Corp. ("NRMC") (collectively, the "Developers") have been engaged in the development, marketing, and sale of lots on the Resort Property. 3D Resorts-Bluegrass is a limited liability company organized under the laws of the Commonwealth of Kentucky, and is the owner and operator of the Resort Property. PlainsCapital Bank provided the financing for the development of the Resort Property, and is a secured lender of 3D Resorts-Bluegrass with a security interest in the real estate development, along with other collateral.

Double Diamond and NRMC are both Texas corporations, and list their principal place of business at the same address in Dallas, Texas. On October 29, 2010, 3D Resorts-Bluegrass and NRMC executed a Green Farm Resort Management Agreement (the "Management Agreement"), pursuant to which 3D Resorts-Bluegrass engaged NRMC to act as its agent with respect to the Resort Property, which included the management and operation of the Resort Property.

When 3D Resorts-Bluegrass or its agents sold individual lots, most purchasers obtained developer financing from 3D Resorts-Bluegrass, although certain purchasers obtained third-party financing or purchased the lot outright. For those financed by 3D Resorts-Bluegrass, the mortgages were serviced by 3D Resorts-Bluegrass, until Double Diamond , NRMC, and/or United Equitable Mortgage Corporation obtained the servicing rights for those mortgages by virtue of the Management Agreement. Double Diamond and United Equitable Mortgage Corporation are affiliates of NRMC, and all of these entities are under the Double Diamond Companies' corporate umbrella.

B. Procedural History

1. The Administrative Action

The Bureau filed this action on June 14, 2013, charging nineteen counts against 3D Resorts-Bluegrass.[1] As set forth in the Notice of Charges, 3D Resorts-Bluegrass and its agents committed various violations of ILSA, harming hundreds of consumers in the Commonwealth of Kentucky and elsewhere.[2] In this action, the Bureau seeks a variety of legal and equitable relief, including restitution, rescission of the mortgages and promissory notes, injunctive relief, and civil money penalties.

On July 2, 2013, this Court held a scheduling conference with the parties, and subsequently issued an Order setting forth discovery deadlines, expert reports, and pretrial

[1] Prior to filing the Administrative Action, and pursuant to its Notice and Opportunity to Respond and Advise policy (similar to the SEC's Wells Notice policy), the Bureau provided both the Chapter 11 Trustee (on March 14, 2013) and counsel for 3D Resorts-Bluegrass (on March 15, 2013) a letter advising that the Bureau's Office of Enforcement was considering recommending a legal action against 3D Resorts-Bluegrass, and inviting both the Trustee and 3D Resorts-Bluegrass to submit a response explaining why the Bureau should not take action.

[2] Upon the Dodd-Frank transfer date (July 21, 2011), the rulemaking and other authority historically vested in HUD under ILSA was transferred to the Bureau. *See* 12 U.S.C. § 5581(b)(7); *see also Bacolitsas v. 86th & 3rd Owner, LLC*, 702 F.3d 676, 675-76 n.1 (2d Cir. 2012) ("Following passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, … the rulemaking and other authority historically vested in [HUD] under the Interstate Land Sales Full Disclosure Act was transferred to the newly created Consumer Financial Protection Bureau.").

submissions. The hearing was scheduled to commence on August 14, 2013. On July 12, 2013, this Court issued an order denying the relief sought by the affirmative defenses raised by the Thomas M. Duddy, the Chapter 11 Trustee of the bankruptcy estate ("Chapter 11 Trustee") and William Palmer, counsel for 3D Resorts-Bluegrass.

2. The Bankruptcy Proceeding

On November 16, 2011, 3D Resorts-Bluegrass filed a voluntary petition for bankruptcy and, following a transfer of venue from the Northern District of Texas, the Chapter 11 bankruptcy proceeding is currently pending as Case No. 11-41599 in the United States Bankruptcy Court for the Western District of Kentucky (the "Bankruptcy Proceeding"). The Bankruptcy Court appointed a Chapter 11 Trustee to manage the debtor's estate. On July 20, 2012, the CFPB filed a proof of claim in the Bankruptcy Proceeding.

On June 17, 2013, the Chapter 11 Trustee and the secured creditor in the Bankruptcy Proceedings, PlainsCapital Bank ("PlainsCapital") sought an order requiring the sale from the Bankruptcy Estate of the promissory notes and related mortgages which are the subject of the Bureau's claims seeking rescission in this action. The Bankruptcy Court entered an order allowing, but not requiring, PlainsCapital to enforce its rights against the promissory notes and mortgages, meaning that PlainsCapital could purchase these notes and mortgages. Counsel for PlainsCapital has advised Bureau counsel that the Chapter 11 Trustee and PlainsCapital transferred the notes within twenty-four hours of the entry of the Bankruptcy Court's order.

On July 9, 2013, the Chapter 11 Trustee filed a motion with the Bankruptcy Court to enforce the automatic stay against the Bureau, alleging that the Bureau's Administrative Action violated 11 U.S.C. § 362, and sought to enjoin the Bureau's Administrative Action against 3D Resorts-Bluegrass. Consistent with the Administrative Law Judge's July 12, 2013 Order, which,

inter alia, struck the Chapter 11 Trustee's affirmative defenses on these grounds, the Bankruptcy Court denied the motion and rejected the Chapter 11 Trustee's attempt to enjoin the instant administrative adjudication proceedings.

On July 29, 2013, the Green Farm Property Owners Association moved to dismiss the bankruptcy. That motion is set for hearing on August 23, 2013.

3. The Kentucky Litigation

On June 17, 2011, the Commonwealth of Kentucky filed a civil action styled *Commonwealth of Kentucky ex rel. Jack Conway, Attorney General v. 3D Resorts Communities LLC et al.*, (Civ. No. 11-CI-212) in the Grayson County Circuit Court, alleging various state law violations (as well as a contract dispute with the state) stemming from the Developers' marketing, sales, and development of the Resort Property. That action was stayed due to the pending Bankruptcy Proceedings. On July 30, 2013, over the objections of the Chapter 11 Trustee and PlainsCapital Bank, the Bankruptcy Court held that the Commonwealth's action was exempt from the automatic stay as it constituted an exercise of the Commonwealth's police and regulatory powers. The Commonwealth of Kentucky's action is currently pending.

II. Legal and Factual Analysis

A. The Interstate Land Sales Act

1. Overview of the Statute

Passed in 1968, ILSA is "an antifraud statute utilizing disclosure as its primary tool" with the principal purpose of "protect[ing] purchasers from unscrupulous sales of undeveloped home sites." *Winter v. Hollingsworth Props., Inc.*, 777 F.2d 1444, 1447 (11th Cir. 1985); *see also Olsen v. Lake Country, Inc.*, 955 F.2d 203, 205 (4th Cir. 1991) (ILSA is a consumer protection statute in that the purpose of the act is to protect purchasers of land from fraud); *Pierce v. Apple*

Valley, Inc., 597 F. Supp. 1480, 1484 (S.D. Ohio 1984) ("The dual purposes of full disclosure and prevention of fraud would be advanced by allowing the Secretary to bring civil actions to enforce the anti-fraud provisions."); *Rockefeller v. High Sky, Inc.*, 394 F. Supp. 303, 304 (E.D. Pa. 1975) ("The Act was obviously designed for the protection of the consumer."). The statute is based on "the full disclosure provisions and philosophy of the Securities Act of 1933," and modeled upon that act. *Flint Ridge Dev. Co. v. Scenic Rivers Ass'n of Oklahoma*, 426 U.S. 776, 778-79 (1976). A central purpose of ILSA is "to insure that a buyer, prior to purchasing certain kinds of real estate, is informed of facts which will enable him to make an informed decision about purchasing the property." *Law v. Royal Palm Beach Colony, Inc.*, 578 F.2d 98, 99 (5th Cir. 1978) (citation omitted). In addition, "[t]he general purpose" of the Act is "to prohibit and punish fraud" in the land sale industry. *McCown v. Heidler*, 527 F.2d 204, 207 (10th Cir. 1975); *see also Cisneros v. Cost Control Mktg. & Sales Mgmt. of Va., Inc.*, 862 F. Supp. 1531, 1533 (W.D. Va. 1994) (noting that ILSA is aimed at halting, deterring, and punishing fraudulent conduct in interstate land sales.").

Importantly, Congress intended that ILSA be liberally construed to achieve its goals of prohibiting and punishing fraud in land development enterprises. *See, e.g., McCown v. Heidler*, 527 F.2d 204 (10th Cir. 1974); *Pierce v. Apple Valley, Inc.*, 597 F. Supp. 1480, 1484 (S.D. Ohio 1984) (construing ILSA restrictively "would not advance the purposes Congress sought to achieve"); *see also SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963) (any legislation passed to address fraud should be construed "not technically and restrictively, but flexibly to effectuate its remedial purpose"); *Timmreck v. Munn*, 433 F. Supp. 396 (N.D. Ill. 1977); *Samara Dev. Corp. v. Marlow*, 556 So.2d 1097 (Fla. 1990) (ILSA is intended to protect public and should be liberally construed in favor of the public interest).

2. Materiality

As set forth below, a number of the claims at issue (Counts I, II, and IV through XI) relate to the materiality of the misrepresentations 3D Resorts-Bluegrass and its agents made.[3] Consistent with ILSA's securities law foundations, courts have looked to those statutes for the legal standard for materiality: "[A] fact stated or omitted is material if there is a substantial likelihood that a reasonable purchaser or seller of a security (1) would consider the fact important in deciding whether to buy or sell the security or (2) would have viewed the total mix of information made available to be significantly altered by disclosure of the fact." *Dunn v. Borta*, 369 F.3d 421, 427 (4th Cir. 2004) (quotations omitted).[4] The test of materiality under ILSA is whether a reasonable purchaser might have considered the omitted fact or erroneous statement as important in making a decision. *Paquin v. Four Seasons of Tenn., Inc.*, 448 F.2d

[3] For a more in-depth discussion of standard for materiality, *see Burns v. Duplin Land Dev.*, 621 F. Supp. 2d 292, 308 (E.D.N.C. 2009):

> The Fourth Circuit has made clear that the fact itself must be material, not the misrepresentation or omission. *See Greenhouse v. MCG Capital Corp*., 392 F.3d 650, 656 (4th Cir.2004). Thus, assuming other requirements are met, any omission of a material fact is prohibited. *See id*. In addition, the materiality inquiry is objective and examines the significance of the omitted fact to a hypothetical reasonable investor, not to the specific plaintiff. *See Nolte v. Capital One Fin. Corp*., 390 F.3d 311, 315 (4th Cir.2004). Further, materiality "does not require proof that an investor would not have invested had he known the truth; rather, the reasonable investor standard requires 'a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable [investor].'" *Dunn*, 369 F.3d at 427 (*quoting TSC Indus*., 426 U.S. at 449, 96 S.Ct. 2126) (alteration in original). Moreover, in the analogous section 12(a)(2) context, the fact that omitted information is publicly available does not defeat materiality as to a seller's omission. *See, e.g*., *Dunn*, 369 F.3d at 429. "[I]nvestors are not generally required to look beyond a given document to discover what is true and what is not." *Miller v. Thane Int'l, Inc*., 519 F.3d 879, 887 (9th Cir.), cert. denied, —— U.S. – ——, 129 S.Ct. 161, 172 L.Ed.2d 43 (2008); *see Dunn*, 369 F.3d at 429.

[4] This standard "does not require proof that an investor would not have invested had he known the truth; rather, the reasonable investor standard requires 'a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable [investor]." *Id.* (quoting *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

680, 695 (5th Cir. 1975); *Burns v. Duplin Land Dev.*, 621 F. Supp. 2d 292, 307 (E.D.N.C. 2009); *Gibbes v. Rose Hill Plantation Dev. Corp.*, 794 F. Supp. 1327 (D. S.C. 1992).[5]

Although 15 U.S.C. § 1703(a) requires materiality, there is no requirement of actual reliance. In ILSA cases, a majority of courts have concluded that the plaintiff need not prove reliance. *See, e.g., Hester v. Hidden Valley Lakes, Inc.*, 495 F. Supp. 48, 53 (N.D. Miss. 1980); *Kenneally v. Bank of Nova Scotia*, 711 F. Supp.2d 1174, 1186 (S.D. Cal. 2010) ("There is substantial authority that a showing of reliance is not required to prove a violation of the Land Sales Act." (citing cases); *Boatwright v. Carney Realty*, 2009 WL 3615048, *11 n.27 (S.D. Ala. Oct. 9, 2009) ("[t]here is substantial authority finding that no reliance is necessary for an aggrieved purchaser to recover under" ILSA (citing cases)); *Paniaquas v. Aldon Cos.*, 2005 WL 1983859, *11 (N.D. Ind. Aug. 17, 2005); *Prebil v. Pinehurst, Inc.*, 638 F. Supp. 1314, 1317 (D. Mont. 1986) ("it is highly questionable that a party must prove reliance under" ILSA).[6] Similarly, proof of scienter is not required to establish an ILSA violation. [7]

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[5] Importantly, the existence of countervailing information does not serve to cure a misrepresentation. "[W]hen a seller draws attention to information which is favorable to the sale of the lot and delays providing contradictory information, a predisposition is created. Any subsequent information of a countervailing nature must be highlighted; it is not sufficient simply to deliver the information to the purchaser. The seller by omission has taken on an affirmative obligation to make the statements clear and unambiguous to the purchaser." *HR Rep. No. 154*, 96th Cong., 1st Sess., reprinted in 1979 United States Code Congressional and Administrative News p. 2317, at 2350-2351; *see also Gentry v. Harborage Cottages-Stuart, LLP*, 602 F. Supp.2d 1239, 1252-55 (S.D. Fla. 2009) (showing site map that had an area marked "Future Development" when the developer know that there were buildings nonconductive to residential living constituted material misrepresentation and omission); *Removatron Int'l Corp. v. FTC*, 884 F.2d 1489, 1497 (1st Cir. 1989) ("Disclaimers or qualifications in any particular ad are not adequate to avoid liability unless they are sufficiently prominent and unambiguous to change the apparent meaning of the claims and to leave an accurate impression. Anything less is only likely to cause confusion by creating contradictory double meanings.")

[6] There is, however, some authority to the contrary, in which courts have required reliance. *See, e.g., Taplett v. TRG Oasis*, Ltd., 755 F. Supp.2d 1197, 1200-02 (M.D. Fla. 2009); *Gilbert v. Woods Mktg., Inc.*, 464 F. Supp. 745, 749 (D. Minn. 1978); *Bryant v. Amrep Corp.*, 429 F. Supp. 313, 320 (S.D.N.Y. 1977). However, even in those cases, many of the courts have acknowledged a presumption of reliance where the statement is material.

Additionally, many of those cases predate Congress' 1979 amendments to ILSA, which expressly deleted the language "upon which the purchase relies" from the provisions of Section 1703(b)(2). *See also* Federal Regulation of Real Estate and Mortgage Lending (4th Ed.) § 3:81 ("The 1979 Amendments also resulted in a somewhat more subtle change. The reference to buyer reliance was deleted. This change was in direct response to judicial holdings that reliance was an element of this prohibition."). Finally, even if this court were to determine

3. 3D Resorts-Bluegrass is Liable for the Actions of Its Agents

As described above, on October 29, 2010, 3D Resorts-Bluegrass entered into the Management Agreement with NRMC. Pursuant to the Management Agreement, 3D Resorts-Bluegrass engaged NRMC to be its agent in connection with the operation of the Resort Property, including, without limitation, management, budgeting, marketing, employment, collections, maintenance, land sales, contracting, funds disbursements, golf course management and operation, hospitality operations and services, and mortgage servicing. In pertinent part, the Management Agreement provides:

> Any person dealing with Agent [NRMC] may rely absolutely upon the act, deed and/or signature of the officers of Agent as being the Acts of Owner [3D Resorts-Bluegrass] and binding solely upon Owner with respect to the services to be performed by Agent on behalf of Owner as described herein.

A corporation may be held liable for the actions of its officers, employees, and other agents.[8] *See*, *e.g.*, *United States v. Brothers Constr. Co.*, 219 F.3d 300, 310-311 (4th Cir. 2000). 3D Resorts-Bluegrass is liable for the actions taken by its agent, NRMC, based on two separate theories of agency liability. First, a principal may be liable for the actions of its agent if the principal expressly or implicitly authorized the conduct. *Jones v. Federated Financial Reserve Corp.*, 144 F.3d 961, 965 (6th Cir. 1998). Here, the Management Agreement entered between the parties on October 29, 2010 gave NRMC express and sweeping authority to act as

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that reliance was an element of an ILSA claim of misrepresentation, the evidence will establish that the purchasers here did rely on the misrepresentations.

[7] Scienter is not required to establish a violation of §1703(a)(2)(A), (B), or (C). *See Pierce v. Apple Valley, Inc.* 597 F. Supp. 1480, 1492 (S.D. Ohio 1984) ("The emphasis is placed upon the effect of the prohibited act, not the intent or knowledge with which it is done."); *accord Ackmann v. Merchants Mortg. & Trust*, 645 P.2d 7, 15-16 (Colo. 1982). Similarly, the Bureau "need not prove that defendants intended to defraud or deceive" or that the property purchasers "relied on the property report," but "need only [ ] show that the misrepresentation or omission existed in the property report at the time the property was sold." *Shirley v. Mann*, No. 90 C 0008, 1993 WL 13666177, at *6 (N.D. Ill. Oct.25, 1993); *Gibbes v. Rose Hill Plantation Development Co.*, 794 F. Supp. 1327 (D.S.C. 1992); *Hester v. Hidden Valley Lakes, Inc.*, 495 F. Supp. 48, 53 (N.D. Miss. 1980) (need not show intent to deceive).

[8] ILSA defines an "agent" as "any person who represents, or acts for or on behalf of, a developer in selling or leasing, or offering to sell or lease, any lot or lots in a subdivision; but shall not include an attorney at law whose representation of another person consists solely of rendering legal services." 15 U.S.C. § 1701(6).

the agent of 3D Resorts-Bluegrass. NRMC was vested with the authority to operate the Resort Property, and 3D Resorts-Bluegrass agreed to be bound by the acts of NRMC.

Additionally, under the theory of apparent authority, a principal may be liable for the acts of its agent if the principal "held the agent out to third parties as possessing sufficient authority to commit the particular act in question, and there was reliance upon the apparent authority." *Jones*, 144 F.3d at 965; *see also Anderson v. Int'l Union Plant Guard Workers of Am.*, 150 F.3d 590, 593 (6th Cir. 1998) ("apparent authority arises in those situations where the principal causes persons with whom the agent deals reasonably to believe that the agent has authority"). This theory is "based upon the fact that the agent's position facilitates the fraud," and that to the consumer, "the agent appears to be acting in the ordinary course of business…." *Am. Soc'y of Mech. Engr's v. Hydrolevel Corp.*, 456 U.S. 556, 566 (1982)), *aff'd*, 526 U.S. 398 (1999). Consequently, "there may be no need to show that the agent acted to further the principal's interests—a showing of 'apparent authority' is often enough." *United States v. Sun-Diamond Growers of California*, 138 F.3d 961, 970 n.9 (D.C. Cir. 1998) (citing *Am. Soc'y of Mech. Engr's*, 456 U.S. at 573-74. Here, 3D Resorts-Bluegrass outwardly indicated to property owners and others that NRMC had its authority and was properly responsible for the Resort Property (including marketing, sales, maintenance, mortgage collections, and a whole host of other responsibilities). 3D Resorts-Bluegrass is liable for the actions of its agents, which were acting well within the scope of their authority designated in the Management Agreement; accordingly, 3D Resorts-Bluegrass cannot now attempt to escape liability.

B. The Counts of the Notice of Charges

The nineteen counts in the Notice of Charges fall within four general categories:

(1) Claims relating to property reports (Counts I through IV);
(2) Claims relating to misrepresentations and material omissions in the marketing and sale of the property (Counts V through XII);
(3) Claims relating to marketing and sale of property following HUD's ordered suspension of such sales (Counts XIII through XV); and
(4) Deficiencies in ILSA required filings (Counts XVI through XIX).

Each violation, including the law and certain facts relevant to the violation, is summarized below.

C. Claims Relating to Property Reports

1. Property Reports Containing Untrue Statements of Material Fact or Omitted Required Facts (Counts I and II) (15 U.S.C. § 1703(a)(1)(C))

As set forth in Counts I and II of the Notice of Charges, 3D Resorts-Bluegrass filed property reports with HUD that became effective on February 26, 2009 and on January 13, 2010, and each of those reports contains untrue statements of material fact or omitted to state material facts. Developers are required to file a Statement of Record with the Bureau, which will generally include: (1) the Property Report, which is given to consumers before they purchase a lot; (2) the Additional Information and Documentation material; and (3) the Annual Report of Activity, if necessary.

Title 15, Section 1703(a)(1)(C) provides, in pertinent part:

> It shall be unlawful for any developer or agent, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce, or of the mails – (1) with respect to the sale or lease of any lot not exempt under section 1702 of this title-- * * * (C) to sell or lease any lot where any part of the statement or record or the property report contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein pursuant to sections 1704 through 1707 of this title or any regulation thereunder; …

15 U.S.C. §§ 1703(a)(1)(C). This provision prohibits a developer or agent from selling or leasing any lot where any part of the statement of record or the property report contains (1) an untrue statement of material fact; or (2) omitted to state a material fact required to be stated in the statement of record or property report.[9]

a. February 26, 2009 Property Report (Count I)

3D Resorts-Bluegrass filed with HUD two separate statements of record that include property reports. The first property report is dated February 26, 2009, and covers Sections 1 through 3 on the Resort Property (the "February 26, 2009 Property Report"). The second property report is dated January 13, 2010, and covers Sections 1 through 4 ("January 13, 2010 Property Report"). The February 26, 2009 Property Report was distributed to purchasers and potential purchasers from approximately February 26, 2009 to January 12, 2010. The January 13, 2010 Property Report was distributed to purchasers and potential purchasers from approximately January 13, 2010 to March 21, 2010.

The February 26, 2009 Property Report contained the following misrepresentations:

- that sufficient funds were escrowed to assure completion of electrical lines in Section 2 of the Resort Property;
- that the installation of a septic tank would cost the consumer only $260; and
- that a loan had been secured for the provision of electrical service in Section 3.

[9] 3D Resorts-Bluegrass is a "developer" within the meaning of the statute because it "directly or indirectly, s[old] or lease[d], or offer[ed] to sell or lease, or advertise[d] for sale any lots in a subdivision." 15 U.S.C. § 1701(a)(5). The Resort Property is a "subdivision," which is "any land which is located in a State or foreign country and is divided or is proposed to be divided into lots, whether contiguous or not, for the purpose of sale or lease as part of a common promotional plan." 15 U.S.C. § 1701(a)(3). There are a number of exemptions available under 15 U.S.C. § 1702, none of which is applicable here. Finally, ample evidence exists and will be presented at the hearing as to 3D Resorts-Bluegrass' use of the mails, interstate communications, and interstate transportation.

While the property report represented that sufficient funds were escrowed to assure completion of certain electric lines in Section 2 of the property, 3D Resorts-Bluegrass has admitted no such funds were in fact escrowed.[10]

The cost sheet attached to the February 26, 2009 Property Report represented that a septic tank installation fee was estimated to be $260 to the consumer, which represents the cost for a site analysis of $115, and a county license fee to operate the septic system of $145. Not included in this figure was the approximate $3,000 cost to install an individual system, which is a cost that would be incurred by any purchaser wishing to build on a lot in Sections 1, 2, or 3. The January 13, 2010 Property Report subsequently listed a one-time estimated cost for an individual septic system to be $6,000, a figure that includes both the connection and the installation costs.

The February 26, 2009 Property Report further represented that 3D Resorts-Bluegrass had secured a loan for the electrification of Section 3 of the Resort Property. However, as 3D Resorts-Bluegrass' own principal acknowledged, although it had a development loan from PlainsCapital, it had not obtained the required authorization to use the funds for the installation of electricity or electric lines in Section 3.

b. January 13, 2010 Property Report (Count II)

The January 13, 2010 Property Report contained several misrepresentations:

- that sufficient funds were escrowed for the completion of electrical lines in Section 2;
- that funds had been secured to construct electrical lines in Section 3;
- that a sewage treatment plant would be constructed in Section 4 by 2011;
- that water lines in Section 2 of the Resort Property were complete;
- that construction of water lines in Section 4 would commence on April 1, 2010 and be completed by the end of 2011; and
- that eight rental cabins were complete and available for use for purchasers.

[10] 3D Resorts-Bluegrass stated in its NORA response that, "[t]he Property Report did incorrectly state that funds were escrowed with Leitchfield Deposit Bank to complete the installation of the electric lines in Section 2 of the subdivision," and classified the misrepresentation as "an unintentional Scribner's [sic] error."

This property report continued to misrepresent that sufficient funds were escrowed to assure completion of certain electric lines in Section 2 of the property, when no such escrow existed. It further continued to misrepresent that a loan from PlainsCapital had been secured to construct the electric lines in Section 3 of the Resort Property. PlainsCapital provided an acquisition and development loan to 3D Resorts-Bluegrass to finance the purchase and development of the Resort Property. As part of that lending agreement, 3D Resorts-Bluegrass had to obtain approval from the bank to use funds from the loan for infrastructure or other improvement projects on the Resort Property. At the time that the January 13, 2010 Property Report was filed with HUD, PlainsCapital had not approved funds for the installation of electric lines in Section 3.

The January 13, 2010 Property Report is the first to cover the lots in Section 4. The lots in Section 4 were too small to allow an owner to install an individual septic system, so a centralized sewage treatment plant would be necessary to make the lots buildable. The January 13, 2010 Property Report misrepresented that a centralized sewage treatment plant would be constructed to service lots in Section 4 beginning on or about April 1, 2010, and should be "completed and available for use" by December 31, 2011. The only steps taken toward the construction of a centralized sewage treatment plant by 3D Resorts-Bluegrass was to submit a request for 3D Resorts-Bluegrass' engineer to start the process of designing the system. Preliminary work on the plans began in October or November of 2009, but these plans were never finished. 3D Resorts-Bluegrass took no subsequent steps toward this construction project until January 2011, and only in May 2011 did it purport to submit an application to obtain the necessary permits from the regulating authority. After HUD served a Suspension Notice on April 19, 2011, Double Diamond or NRMC sent two responsive letters to HUD. The second

letter is dated May 31, 2011, and attached to it are sewer plans and an application for a construction permit to the Commonwealth of Kentucky's Division of Water dated May 12, 2011. Those were the first plans that were completed for the centralized sewage treatment plant and the first application submitted for construction permits. The sewage treatment plant has still never been constructed, and thus these lots are completely unbuildable.

The January 13, 2010 Property Report also stated that water lines for Section 2 of the Resort Property were complete, when, as of September 14, 2010, the Grayson County Water District refused to accept the water lines into its system due to outstanding issues with the construction of the water lines, some of which had been outstanding since April 1, 2010. The form real estate contract used by 3D Resorts-Bluegrass and its agents at that time indicated that water lines for Section 2 would be completed in 2010, as opposed to the lines being complete. In contrast, the water lines for Section 1 were described as being complete in both the property report and form real estate contract.[11]

This property report also states that construction of the water lines in Section 4 of the Resort Property would begin on or about April 1, 2010, and the lines were expected to be completed on or before December 31, 2011. At the time of this representation, although 3D Resorts-Bluegrass was working on plans for the water lines (that do not appear to have been completed) and may have put the job out for bid to contractors, it had not applied for any permits nor was it in a position to commence construction. Section 4 is still without completed water lines.

[11] Untrue statements or omission solely within the property report are violations of 15 U.S.C. § 1703(a)(1)(C), and therefore, cannot be cured by supplemental information. *See Burns v. Duplin Land Dev., Inc.*, 621 F. Supp. 2d 292, 307 (E.D.N.C. 2009) ("Because section 1703(a)(1)(C) targets "any part" of a property report which contains an omission of material fact, the court declines to hold that the statement of record or oral statements may supplement the property report.").

The January 13, 2010 Property Report misrepresented that eight rental cabins were complete and available for use at a discounted rate for members. At the time this property report was filed, at most two cabins were complete and available for rent. Five more cabins were eventually completed after October 2010, but at no time were eight rental cabins ever completed and available for use.

The misrepresentations 3D Resorts-Bluegrass made in the property reports are untrue statements of material fact and constitute violations of 15 U.S.C. § 1703(a)(1)(C). The above-listed misrepresentations are untrue statements regarding material facts contained in the property reports filed by 3D Resorts-Bluegrass or its agent, and such representations were either tangibly untrue at the time of the representation (such as the existence of eight "complete" cabins), or were not in good faith at the time of the filing of the property reports and at the time of purchase by consumers.

Each of the above-listed facts goes to either the cost or value of the lot (*e.g.*, septic tank costs, central sewage system construction, central sewage maintenance, access to water), the salability of the lot (*e.g.*, escrowed funds to complete electrical work, construction of central sewage is necessary because lots are too small for individual systems, availability of rental cabins), or both. By way of example, as acknowledged by 3D Resorts-Bluegrass' principal, there is a difference in value of a lot that is assured to have electric lines supplied to it via escrow as opposed to merely having electric lines run from another section. Further, all lots on the Resort Property are for single-family housing, and absent a central sewage system, Section 4 lots are completely unbuildable. In addition, 3D Resorts-Bluegrass's principal testified that the amenity of the rental cabins was considered a selling point to potential purchasers and that 3D Resorts-Bluegrass marketed this amenity to induce consumers to purchase lots.

Moreover, 12 C.F.R. §§ 1011.10-30 sets for certain unlawful sales practices, and provides examples of practices that are considered misleading. *See* 12 C.F.R. § 1011.10. One such example is set forth in 12 C.F.R. § 1011.20(i), which notes that it is an unlawful sales practice for any developer or agent, directly or indirectly, in the selling, leasing or offering to sell or lease any lot in a subdivision to represent a lot as a homesite or building lot unless:

(1) potable water is available at a reasonable cost;
(2) the lot is suitable for septic tank operation or there is reasonable assurance that the lot can be served by a central sewer system;
(3) the lot is legally accessible; and
(4) the lot is free from periodic flooding.

The lots in Section 4 are without water line service and without a reasonable assurance those lots will be served by a central sewer system. The regulation provides that these representations made with respect to lots in Section 4, which were marketed as properties zoned for single-family residential use and for site built homes only, was an illegal sales practice.

2. Unfiled Property Report Distributed to Purchasers and Potential Purchasers (Count III) (15 U.S.C. § 1703(a)(1)(B))

As pled in Count III of the Notice of Charges, in response to concerns raised by the Office of the Attorney General for the Commonwealth of Kentucky, 3D Resorts-Bluegrass revised its January 13, 2010 Property Report in several material ways. Although these revisions were made on or about March 22, 2010, the Property Report retained the January 13, 2010 date on its cover, and for purposes of this memorandum, the document shall be referred to as the "March 22, 2010 Property Report." Despite the fact that 3D Resorts-Bluegrass never filed the March 22, 2010 Property Report with HUD, 3D Resorts-Bluegrass began providing the March 22, 2010 Property Report to purchasers and potential purchasers with the false implication that it was the official Property Report that had been filed with HUD and was effective.

Section 1703(a)(1)(B) of ILSA prohibits a developer or agent from selling or leasing any lot unless a printed property report, meeting specific ILSA requirements, is furnished to a purchaser in advance of the signing of any contract or agreement.[12] A developer may not use a property report for any promotional purpose before the statement of record, which includes the property report and is filed with HUD, becomes effective. 15 U.S.C. § 1707(b). Generally, the effective date for an initial, consolidated, or amended statement of record is 30 days after the filing of the latest amendatory material. 12 C.F.R. § 1010.21(a).

3D Resorts-Bluegrass's revisions constituted material changes to the property report, which required 3D Resorts-Bluegrass to file an amendment to an effective statement of record and wait the requisite timeframe for the amendment to be deemed effective before distributing it to potential purchasers of lots. Properly filing the amendment at that time would have alerted HUD to the misrepresentations that had been in the property report for over a year. Because 3D Resorts-Bluegrass did not file it, however, the March 22, 2010 Property Report did not meet the requirements of 15 U.S.C. § 1707, and therefore, distributing it to purchasers of lots on the Resort Property meant that purchasers from March 22, 2010 forward were not furnished with an effective property report prior to signing their agreements to buy the lots.[13]

[12] 15 U.S.C. § 1703(a)(1)(B) provides:

> It shall be unlawful for any developer or agent, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce, or of the mails – (1) with respect to the sale or lease of any lot not exempt under section 1702 of this title-- * * * (B) to sell or lease any lot unless a printed property report, meeting the requirements of section 1707 of this title, has been furnished to the purchaser or lessee in advance of the signing of any contract or agreement by such purchaser or lessee; ….

[13] Apparently, 3D Resorts-Bluegrass never informed any of those purchasers that they had never been provided with an effective property report.

3. Unfiled Property Report Contained Untrue Statements of Material Fact or Omitted Material Fact (Count IV)

As set forth in Count IV of the Notice of Charges, even if this March 22, 2010 Property Report had been filed with HUD (and it had not been), the report itself repeated a number of material misrepresentations that existed in the January 13, 2010 Property Report. The changes to the January 13, 2010 Property Report that were reflected in the March 22, 2010 Property Report were amendments to an effective Statement of Record, which were required to be filed with HUD. Despite 3D Resorts-Bluegrass' failure to file the March 22, 2010 Property Report, this document may still be considered a Property Report for purposes of 15 U.S.C. § 1703(a)(1)(C).

The term "Property Report" is not a defined term under ILSA or its implementing regulations, and based upon its usage in other provisions of the statute, that term does not appear to be limited to effective and filed Property Reports. For example, Section 1707(b) of ILSA provides, "The property report shall not be used for any promotional purposes before the statement of record becomes effective and then only if it is used in its entirety." This section appears to contemplate that a "property report" can exist as a legal matter before it is filed and becomes effective.

ILSA prohibits a developer or agent from using interstate commerce or the mails to sell or lease any lot where any part of the statement of record or the property report contains an untrue statement of material fact or omitted to state a material fact required to be stated in the statement of record or property report. See 15 U.S.C. § 1703(a)(1)(C). As set forth above, 3D Resorts-Bluegrass began distributing the March 22, 2010 Property Report on or about March 22, 2010. Other than removing representations about the funding for the construction of electric lines to Sections 2 and 3, the March 22, 2010 Property Report is the same as the January 13, 2010 Property Report, and therefore, it contains all the same misrepresentations set forth in

Section II.C.2.b above. In addition, the March 22, 2010 Property Report represented that a General Store (an historic building on the Resort Property, and one of the landmarks of the resort) was completed and available for use, despite the fact that on or about February 6, 2010, the General Store had been completely destroyed in a fire.

For the same reasons set forth in Section II.C.2.b above, the misrepresentations made by 3D Resorts-Bluegrass, LLC in the March 22, 2010 Property Report are untrue statements of material fact and constitute violations of 15 U.S.C. § 1703(a)(1)(C). Further, the misrepresentations about the General Store being complete and available for use goes to both the value and the salability of the lots. According to 3D Resorts-Bluegrass' principal, Ronald Newman, having a General Store was considered a selling point to potential purchasers and 3D Resorts-Bluegrass marketed it as an amenity on the Resort Property.

D. Untrue Statements of Material Fact in the Marketing and Advertising of Lots on the Resort Property

3D Resorts-Bluegrass made several misrepresentations related to the infrastructure and the amenities available on the Resort Property in the sale and marketing of lots through its sale presentations and other marketing efforts. Each misrepresentation set forth below constitutes a violation of Sections 1703(a)(2)(A), (B), and (C) of ILSA.

"In addition to setting up specific disclosure requirements, the ILSA also contains a general anti-fraud provision that makes it illegal to obtain money or property in connection with a development by means of a material false statement or any omission of a material fact necessary to make the statement made not misleading." *Rice v. Branigar Org., Inc.*, 922 F.2d 788, 791 n.4 (11th Cir. 1991). ILSA prohibits developers and agents from using interstate commerce or the mails with respect to the sale of nonexempt property "to employ any device, scheme, or artifice to defraud." 15 U.S.C. § 1703(a)(2)(A). Similarly, Section 1703(a)(2)(B)

prohibits developers and agents from using interstate commerce or the mails with respect to the sale or offer to sell a lot to obtain money or property by means of material false statements or material omissions. Finally, Section 1703(a)(2)(C) provides that a developer or agent may not use interstate commerce of the mails "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon a purchaser." These provisions of Section 1703(a)(2) address conduct not only in connection with the sale of property but also in the offer to sell property. The regulations implementing ILSA provide that "promotional statements or material will be judged on the basis of the affirmative misrepresentations contained therein and the reasonable inferences to be drawn therefrom." 12 C.F.R. § 1011.25. Materiality is determined by whether a reasonable consumer might have considered the omitted fact or erroneous statement as important in making a decision. *See Burns, Inc.*, 621 F. Supp. 2d at 307. Facts that go to the value or salability of a lot have been found to be material. *See Prebil v. Pinehurst, Inc.*, 638 F. Supp. 1314, 1317 (D. Mont. 1986).

1. Misrepresentations Regarding a Manmade Lake (Count V)

3D Resorts-Bluegrass falsely represented orally and on maps that a large (80-acre) manmade lake was being constructed on the property, and marketed certain lots as "lakefront" and "lake view" lots in Sections 2 and 3. For lots that would not abut the manmade lake, 3D Resorts-Bluegrass advertised the lake as an amenity that would be available to owners of lots on the Resort Property. An April 3, 2010 article in a local paper reported that 3D Resorts-Bluegrass' principal, Ronald "J.R." Newman, explained that 3D Resorts-Bluegrass planned to construct an 80-acre lake on the Resort Property.

The lake was going to be located in an area dedicated as wetlands, and a number of lots in that same area are deemed to be in a flood plain or flood-prone, which makes it questionable

whether such a lake would be even viable in that location. The only basis 3D Resorts-Bluegrass has pointed to for believing such a manmade lake was feasible was walking the property with an engineer, Richard Solis, and the engineer's statements that the location "would be a good spot for the lake to be in." 3D Resorts-Bluegrass made no additional efforts to ensure the lake could be constructed, and despite this lack of due diligence, the construction of a manmade lake was marketed as an amenity on the Resort Property, and was visually depicted on maps provided or shown to prospective purchasers. Records from the Army Corps of Engineers further corroborate that 3D Resorts-Bluegrass never applied for any of the required permits to construct this lake, which is directly at odds with representations made to consumers. Newman further testified at his investigational hearing that the lake was part of the sales presentation, and considered a "selling point" for potential purchasers.

Based on consumer statements and the statements of 3D Resorts-Bluegrass and its agents, the representations were misleading to purchasers and potential purchasers, even taking into account the disclosures that such a lake was only "proposed." Those disclosures are unlikely to cure the misrepresentations made during other various points in the presentation. As Newman, 3D Resorts-Bluegrass' principal, testified:

> Q. Are you aware of any of the lots that are supposed to be next to the lake being sold as lakefront?
>
> A. Yeah, I'm even sure the ones that – on the proposed map that show where that – where the proposed lake would be, yes, they would think they were going to get a lake.

The fact that 3D Resorts-Bluegrass did not conduct the necessary due diligence to know if a manmade lake was feasible at that location; never developed any plans for the construction of the lake; never applied for the appropriate permits for construction of a lake in a wetland area that includes flood plains and flood-prone lots; falsely indicated that they had obtained permits from

the Army Corps of Engineers to construct the lake; and never advised purchasers and prospective owners that they were purchasing land within the flood plain makes the statements as to the planned construction of a lake or marketing lots as "lakefront" (and others as "lake access") materially untrue. In discussing the importance of material omissions, the legislative history to the 1979 amendments of ILSA states that: "In this circumstance an advertisement for 'lakeside property' which omits to state that the lake was dry for six months of the year or an advertisement for 'homesites' which fails to mention that the land was inappropriate for septic tanks and a municipal sewage system was unavailable would be misleading." H.R. Rep. 96-154 at 35 (1979), *reprinted in* 1979 U.S.C.C.A.N. 2317, 2351.

2. Misrepresentations Regarding an RV Park (Count VI)

3D Resorts-Bluegrass falsely represented that a RV park would be constructed on the Resort Property, and would be available to property owners at a discount. The RV Park was an amenity highlighted on the maps provided to potential purchasers as well as being a part of the sales presentation. The RV Park was supposed to be near the cabins that were being built, so there was some grading and leveling done to prepare the site in early 2009 at the same time that the ground was prepared for the construction of the cabins. However, 3D Resorts-Bluegrass shifted resources away from the RV Park and to the construction of the cabins. With the cabins uncompleted, 3D Resorts-Bluegrass made no additional efforts to build an RV Park. Accordingly, the failure to inform purchasers of these redirected funds also constitutes a material omission. 3D Resorts-Bluegrass considered the RV Park a selling point to potential purchasers, and several consumers considered this in deciding to purchase their lots.

3. Misrepresentations Regarding Centralized Sewage System (Count VII)

As set forth above in Section II.C.1.b, 3D Resorts-Bluegrass falsely represented that a centralized sewage treatment plant would be constructed to service lots in Section 4. A treatment plant was necessary there because the lots in Section 4 were too small to allow an owner to install an individual septic system. A centralized sewage treatment plant is the only way to make those lots buildable. In addition to the representations 3D Resorts-Bluegrass made in the property reports, part of the sales presentation to potential purchasers of lots in Section 4 was to inform them "that unit[s] [in Section] 4 would come with sewer." Moreover, the legislative history to ILSA's 1979 Amendments highlighted exactly this concern in Congress's discussion of material omissions:

> The seller by omission has taken on an affirmative obligation to make the statements clear and unambiguous to the purchaser. This is particularly important where the primary contact between the purchaser and the seller is through advertising or the mails. In this circumstance an advertisement for "lakeside property" which omits to state that the lake was dry for six months of the year or an advertisement for "homesites" which fails to mention that the land was inappropriate for septic tanks and a municipal sewage system was unavailable would be misleading.

H.R. Rep. No. 96–154, at 33 (1979), *reprinted* in 1979 U.S.C.C.A.N. 2317, 2351.

4. Misrepresentations Regarding Water Lines in Sections 2 and 4 (Count VIII)

As set forth in Section II.C.1.b, 3D Resorts-Bluegrass falsely represented that water lines in Section 2 were complete despite not being accepted into Grayson County's water system, and falsely represented the construction timeline for water lines for Section 4. During the introductory part of the sales presentation when discussing the property report, 3D Resorts-Bluegrass instructed its sales personnel and its agents to tell prospective purchasers that:

> Here is a copy of our HUD report. It contains all of the information I have just covered with some additional information on tax rate and utilities. We provide central water and electricity.

Correspondence from the Grayson County Water District demonstrates that the Section 2 lines were not accepted by the county, and, in fact, the county advised 3D Resorts-Bluegrass in September 2010 that it might cut off the lines completely if certain repairs were not made. The correspondence advised:

> The amount of work now needed to make this satisfactory to the Water District for this point is too large and detailed to describe in a letter. A meeting should be arranged between the owner of 3D Resort, the Water District, and the District[']s consultant. It is unfortunate that it has come to the point that a hand must be held, but the level of confidence due to the assurances made and unfulfilled by your organization leave us little choice.

Similarly, in December of 2010, the Water District further advised that although certain reclamation work was considered "suitable" but stated that it should not be "construed as complete," but rather that the lines would need to be retested in the spring of 2011 because such work had been made so late in the season.

Representations that the construction of water lines in Section 4 would commence within approximately 3 ½ months, and that "we provide central water and electricity" are similarly false, were false when made, and omitted material facts. Indeed, the same September 14, 2010 letter from the Grayson County Water District informed 3D Resorts-Bluegrass that, in addition to the extensive problems involving the Section 2 water lines, "no future extensions will even be considered until this project is closed out."

5. Misrepresentations Regarding Rental Cabins (Count IX)

As set forth in II.C.1.b, beginning no later than January 13, 2010, 3D Resorts-Bluegrass falsely represented that eight rental cabins were "100%" complete and available for use at a discounted rate for members. Further, during the introductory portion of the sales presentation, 3D Resorts-Bluegrass instructed its sales personnel and its agents to tell prospective purchasers, "Our amenities presently include … 10 rental cabins." As of January 2010, however, only two

cabins were complete and available for rent. Five more cabins were completed after October 2010, but at no time were eight or ten rental cabins completed and available for use. 3D Resorts-Bluegrass considered this amenity a selling point to potential purchasers, and prospective purchasers on tours expressed how much they liked the idea of being able to engage in various activities on the Resort Property and then have the accommodations of the cabins also available.

6. Misrepresentations Regarding the General Store (Count X)

As set forth above, 3D Resorts-Bluegrass falsely represented that the General Store on the Resort Property was completed and available for use despite the building burning down on or about February 6, 2010. Further, during the introductory portion of the sales presentation, 3D Resorts-Bluegrass instructed its sales personnel and its agents to tell prospective purchasers, "Our amenities presently include … [a] General Store." There are and were no plans to rebuild the General Store, and its availability continued to be advertised even after the Store had been destroyed. According to the testimony of 3D Resorts-Bluegrass' principal, 3D Resorts-Bluegrass considered this General Store a selling point to potential purchasers, and the availability of this amenity affects both the value and the salability of the lots on the Resort Property.

7. Misrepresentations Regarding the Historical Pricing Data (Count XI)

3D Resorts-Bluegrass developed pricing sheets that overstated the sales price of Green Farm Resort lots previously sold. This pricing sheet or "inventory" list provides a list of lots with ostensible historical sales prices. However, when compared to the Grayson County tax records and the mortgage servicing records, the prices listed on the inventory sales list are grossly inflated. For those lots in which the Bureau obtained the most reliable information (where the tax records and servicing reports listed the same sales price for the lot), the "inventory" list price exceeded the confirmed sale price by 76% on average. (So, by way of

example, 3D Resorts-Bluegrass would represent that a certain property was sold for $58,800, although that property had sold for only $23,900. In another example, 3D Resorts-Bluegrass represented that another lot had sold for $58,800, although that property had actually sold for only $19,900.)

3D Resorts-Bluegrass made these pricing sheets available to prospective purchasers in the Resort Property sales office. The pricing sheets 3D Resorts-Bluegrass (or its agents) used in the marketing and sale of lots supported the misrepresentation 3D Resorts-Bluegrass staff made in the sales pitch that a lot was available that day for a reduced price. The "Program," an internal marketing booklet with which 3D Resorts-Bluegrass directed its staff about what to say and how to say it during the sales pitch on tour with prospective purchasers, instructed sales personnel to make their pitches with comparisons to other lots sold and to disclose the apparent sales prices of those other lots.

The pricing sheets presented to prospective purchaser by 3D Resorts-Bluegrass, however, contained inflated sales prices of the previously-sold lots, so that consumers would believe that they were receiving a discounted sale price.[14] The sales price of purchased lots on the Green Farm Resort property is material to a purchaser making an informed decision. 3D Resorts-Bluegrass and its agents repeatedly misrepresented historical sales prices of "comparable" lots, leading purchasers and prospective purchasers to believe that their purchase prices were appropriate or that they were somehow getting a "good deal" on a property.

E. Continued Sale of Lots Post Suspension Notice (Counts XII-XV)

Prior to the Consumer Financial Protection Act transfer date – and during the timeframe at issue here – the Secretary of HUD was entitled to suspend the effective date of any statement

[14] The "Program" also instructed sales representatives to tell consumers that there were sales incentives to offer bargain prices, and manager's "promotions" which would further lower the prices.

of record or any amendment thereto upon finding that the statement of record or any amendment on its face was incomplete or inaccurate in any material respect. 12 C.F.R. § 1011.25. Developers are prohibited from selling or leasing any lot unless a statement of record with respect to any such lot is in effect. *See* 15 U.S.C. § 1706(b); 12 C.F.R. § 1010.45(a). A suspension may continue until after the necessary amendments are submitted that correct all of the deficiencies cited in the notice. 12 C.F.R. § 1010.45(a)(2).

On April 19, 2011, the Secretary of HUD issued a Suspension Notice to 3D Resorts-Bluegrass, LLC, NRMC, and Double Diamond with respect to the Green Farm Resort property pursuant to 15 U.S.C. § 1706(b) and 12 C.F.R. § 1010.45(a) (the "Suspension Notice"). The Suspension Notice advised the parties of the deficiencies apparent in their recent filings and how to correct these deficiencies, and informed them of their right to a hearing before an Administrative Law Judge. After the transfer date, HUD provided the CFPB with its file on the Resort Property. No corrective actions were taken by the developers.

The Suspension Notice further advised that, absent an exemption or correction of the deficiencies, the sale or lease of properties would further violate ILSA. Newman (the principal of 3D Resorts-Bluegrass) testified that he received the Suspension Notice himself, and that he discussed the Notice with the CEO of Double Diamond and NRMC, Michael Ward, who also received it. Despite this Suspension Notice barring further sales, 3D Resorts-Bluegrass and its agents continued to sell lots on the Green Farm Resort property.[15]

[15] In a letter to the Kentucky OAG, 3D Resorts-Bluegrass, LLC and Double Diamond claimed to be operating under the ILSA "intrastate" exemption, which permits sales within the state. But the Kentucky OAG determined that the developers failed to comply with Kentucky state rules to meet the intrastate exemption (such as posting full performance bonds). In their respective NORA submissions, neither 3D Resorts-Bluegrass nor the Trustee mentioned the intrastate exemption as a potential defense or explanation for the post-suspension sales on the Resort Property. Finally, there is ample evidence of interstate marketing well after the suspension date.

The sale of lots after the service of the Suspension Notice is a violation of 15 U.S.C. § 1703(a)(1)(A), which prohibits the sale of any lot unless a statement of record with respect to such lot is in effect. The Suspension Notice served upon 3D Resorts-Bluegrass, NRMC, and Double Diamond meant that no statement of record was in effect with respect to the lots the Developers were marketing and selling on the Green Farm Resort property, and yet, the Developers sold lots after service of the Suspension Notice.

Additionally, because a Section 1703 violation does not require a consummated sale, but rather only the "use of any means or instruments of transportation or communication in interstate commerce, or of the mails" for one of the purposes listed in Sections 1703(a)(1) and (a)(2), its post-suspension mailings and other marketing activities themselves constitute ILSA violations. Accordingly, Count XIV of the Notice of Charges pleads this unlawful post-suspension sales activity, which occurred between April 19, 2011 and July 24, 2011 and targeted thousands of potential purchasers.

F. ILSA Filing Violations

1. Failure to File Required Annual Reports of Activity (Count XVI) (24 C.F.R. § 1710.310 (now codified at 12 C.F.R. § 1010.310)) and Failure to File Financial Statements (Count XVII) (24 C.F.R. § 1710.212 (now codified at 12 C.F.R. § 1010.212))

Under ILSA's implementing regulations, 12 C.F.R. Part 1010, a developer must submit a copy of its latest financial statements within 120 days after the close of each fiscal year after the initial effective date of the statement of record. 12 C.F.R. § 1010.212(d). A developer also must file an annual report of activity on any initial or consolidated registration that is not under suspension annually from the effective date of the initial statement of record. 12 C.F.R. § 1010.310(b).

3D Resorts-Bluegrass failed to file both the financial statements and the annual report of activity required under the regulations implementing ILSA. The April 19, 2011 Suspension Notice cited these deficiencies, advising that the financial statement was due on April 30, 2010, nearly a year overdue at the time the April 19, 2011 Suspension Notice was served, and that two separate annual reports of activity were due for 2010 and 2011, both were also overdue when the April 19, 2011 Suspension Notice was served. 3D Resorts-Bluegrass continues its failure to file timely financial statements.

3D Resorts-Bluegrass' failure to timely file financial statements and annual reports of activity are violations of 12 C.F.R. §§ 1010.212 and 1010.310, respectively.

2. Failure to Timely File Amendments to the Statement of Record (Counts XVIII-XIX) (24 C.F.R. § 1710.23 (now codified at 12 C.F.R. § 1010.23))

Pursuant to ILSA's implementing regulations, if any change occurs in any representation of material fact required to be stated in an effective statement of record, an amendment must be filed within 15 days of the date on which the developer knows, or should have known, that there was a change in material fact. 12 C.F.R. § 1010.23(a); *see also* 15 U.S.C. § 1706(c).

3D Resorts-Bluegrass in two separate instances failed to file timely amendments to the statement of record after the occurrence of a change in material fact. First, as set forth in Section II.C.3, above, on or about February 6, 2010, the General Store on the Resort Property burned down. Second, on or about October 29, 2010, 3D Resorts-Bluegrass entered into a Management Agreement with NRMC that effectively turned over control of the operation and development of the Resort Property to NRMC.

Developers are required to disclose certain recreational facilities in a property report. 12 C.F.R. § 1010.114. The General Store was one such recreational facility, and was disclosed as a

recreational facility in the January 13, 2010 Property Report. The fact that the General Store no longer existed as of February 6, 2010 necessitated the filing of an amendment to the statement of record covering the Resort Property. Similarly, 3D Resorts-Bluegrass was required to timely file an amendment reflecting the Management Agreement, but instead of filing within the required 15 days, 3D Resorts-Bluegrass waited five months to do so. Developers are required to disclose in the property report their contact information. This information is disclosed, in part, so potential purchasers and purchasers can contact the developer for answers to questions and information about the subdivision. 12 C.F.R. § 1010.108; *see also* Section XIII of the Appendix to 12 C.F.R. part 1010. With NRMC taking control of the operation and development of the Resort Property, its contact information should have been listed on the property report, and therefore, an amendment to the statement of record was required.

III. Potential Remedies

If the Bureau were to prevail on its claims, there are several potential remedies available which would provide relief to affected consumers and would vindicate the public interest. Section 1055 of the CFPA (12 U.S.C. § 5565) provides that the Bureau has "jurisdiction to grant *any appropriate legal or equitable relief* with respect to a violation of Federal consumer financial law, including a violation of a rule or order prescribed under a Federal consumer financial law", 12 U.S.C. § 5565(a)(1) (emphasis added). Under this Section, there are several forms of relief available to the Bureau in enforcement actions, including rescission or reformation of contracts (including, as applicable here, the promissory notes and mortgages by affected consumers); refunds of moneys or return of real property; restitution, disgorgement, or compensation for unjust enrichment; monetary damages; public notification of the violation, including the costs of such notification; limits on the activities of functions of the person; and

civil money penalties. *See* 12 U.S.C. § 5565(a)(2)(A)-(H). Notably, this list is not exhaustive, as Congress expressly provided that the enumerated list is "without limitation." 12 U.S.C. § 5565(a)(2).

Furthermore, ILSA also provides remedies for public enforcement actions brought by the Bureau. In addition to availability of civil money penalties pursuant to 15 U.S.C. § 1717a, injunctive relief is also available pursuant to 15 U.S.C. § 1714(a). Pursuant to this authority, ILSA not only provides injunctive relief, but the full panoply of remedies available in equity. *See, e.g.*, *Pierce v. Amaral*, 938 F.2d 94, 95-96 (8th Cir. 1991) ("By authorizing the Secretary [of HUD] to seek an injunction, section 1714(a) allows the Secretary to invoke the district court's equitable jurisdiction. When 'Congress allows resort to equity for the enforcement of a statute, all the inherent equitable powers of the district court are available for the proper and complete exercise of the court's equitable jurisdiction, unless the statute explicitly, or "by a necessary and inescapable inference," limits the scope of that jurisdiction.'") (citing, *inter alia*, *Porter v. Warner Holding Co.*, 328 U.S. 395, 398 (1946)). Furthermore, Section 1713 provides that "[t]he rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity." *See also Kemp v. Cost Control Mktg.*, 790 F. Supp. 1275 (W.D. Va. 1992), *aff'd* 64 F.3d 920 (4th Cir. 1995) (disgorgement of profits); *Cisneros v. Cost Control Mktg.*, 862 F. Supp. 1531 (W.D. Va. 1994), *aff'd*, 64 F.3d 920 (4th Cir. 1995) (restitution obligation not discharged under Section 524(a)(2) of the Bankruptcy Code); *Kemp v. Peterson*, 940 F.2d 110 (4th Cir. 1991) (freezing of individual officers' assets and requiring money received from sales be put into escrow).

The Supreme Court has repeatedly ruled that where "the public interest is involved . . . those equitable powers assume an even broader and more flexible character than when only a

private controversy is at stake." *Porter v. Warner Holding Co.*, 328 U.S. 395, 398 (1946); *accord Virginian Ry. Co. v. Sys. Fed'n No. 40*, 300 U.S. 515, 552 (1937) ("Courts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved.") (collecting cases); *United States v. First Nat'l City Bank*, 379 U.S. 387, 384 (1965) (same); *Golden State Bottling Co. v. NLRB*, 414 U.S. 168, 179-180 (1973) (same). *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 purpose. As this Court has long ago recognized, 'there is inherent in the Courts of Equity a jurisdiction to . . . give effect to the policy of the legislature.'") (citing *Clark v. Smith*, 38 U.S. 195, 203 (1839)).

In light of this broad, flexible power to afford "complete relief", *see Mitchell*, 361 U.S. at 291, coupled with the legislative purpose that ILSA be interpreted broadly to effect its remedial purposes, *see* Section II.A.1, above, this Court has the authority to order that consumers affected by the misrepresentations made by 3D Resorts-Bluegrass should have the option to rescind their original sales contracts from the debtor and to obtain full restitution of the funds paid towards the mortgage (including down payments, mortgage principal and interest payments, and other fees or charges associated with the mortgage or purchase).[16] As noted above, and as the evidence will

[16] *See, e.g.*, *SEC v. Towers Credit Corp.*, 1988 WL 219468, at *1, 88 Civ. 5421, SWK, SEC Docket 398 (S.D.N.Y. 1988) (ordering defendants to offer rescission to all note purchasers and to report about each and every sale of notes since note distributions began for violations of registration provisions of securities laws); *SEC v. Bangor Punta Corp.*, 331 F. Supp. 1154, 1162 (S.D.N.Y. 1971), *aff'd in part sub nom. Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir. 1973) (ordering defendant in SEC suit to offer rescission to public buyers it defrauded, even if the market value of the securities the public received from the defendant exceeds the market value of the securities the public surrendered); *SEC v. Drexel Burnham Lambert, Inc.*, 956 F. Supp. 503, 505 (S.D.N.Y. 1997), *aff'd sub nom. SEC v. Fischbach Corp.*, 133 F.3d 170 (2d Cir. 1997) ("As both this Court and the Second Circuit observed in their opinions in this case, 'once the equity jurisdiction of the district court has been properly invoked

show, most lot purchasers now possess property valued at only a fraction of the original purchase price, and without any realistic chance of developing their lots; yet these same consumers face tens of thousands of dollars of debt based on mortgages they took with 3D Resorts-Bluegrass, the same party who made these misrepresentations. Similarly, rescission may be particularly appropriate here because the prospects of meaningful monetary are largely affected by the fact that 3D Results-Bluegrass is a debtor in bankruptcy.

As discussed above, on July 18, 2013, over the Bureau's objections,[17] the Chapter 11 Trustee transferred the mortgage notes and promissory notes to PlainsCapital via a UCC sale. Accordingly, if this Court were to order rescission, the Bureau might seek to enforce that order against the current holder of those notes, PlainsCapital.[18]

In addition or if the Court declines to order rescission, 3D Resorts-Bluegrass should be ordered to provide for restitution to the affected consumers/property owners, arguably up to the full amount of the amount the consumer/property owner paid to 3D Resorts-Bluegrass, LLC and its agents. Similarly, the Court could order disgorgement to divest the wrongdoer of unjust enrichment and to deter others from committing similar unlawful activity. *SEC v. First Jersey Sec. Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996) (in cases of securities law violations, the District Court "has broad equitable power to fashion appropriate remedies, including ordering that culpable defendants disgorge their profits").

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by a showing of a securities law violation, the court possesses the necessary power to fashion an appropriate remedy.'") (quoting *SEC v. Drexel Burnham Lambert, Inc*., 837 F.Supp. at 614, *aff'd* 16 F.3d at 521 (both quoting *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1103 (2d Cir.1972)); *FTC v. Amy Travel Serv., Inc.*, 875 F.2d 564, 571 (7th Cir. 1989) (district courts have ability to grant equitable relief as necessary, including rescission, even though Section 13(b) of the FTCA does not list rescission as an appropriate remedy).

[17] On July 18, 2013, the Bureau appealed Bankruptcy Court's July 17th Order authorizing this transfer via the UCC sale; the Trustee transferred the notes to PlainsCapital that same afternoon. The appeal remains pending.

[18] At the July 17, 2013 hearing before the Bankruptcy Court, the Court expressly noted that "[i]f the sale were to be approved, Plains would just simply stand in the shoes of the debtor [3D Resorts-Bluegrass]. And they take those notes subject to whatever challenges or whatever rights and whatever challenges or claims there are against them." Counsel for PlainsCapital then conceded this point, but asserted that PlainsCapital would take the position that it was a holder in due course.

Injunctive relief is also appropriate. Various property reports for the Green Farm Resort property—as well as a number of related marketing and other material—represented to prospective purchasers that the Developers had secured existing financial arrangements for the continued development of the property. For instance, the February 26, 2009 Property Report (which was provided to at least eighty consumers who purchased Section 2 properties) stated that sufficient funds were escrowed in Leitchfield Deposit Bank to assure completion of electrical service lines in Section 2 of the Resort Property. Similarly, some of the water supply lines in Section 2 have not been maintained, and need to be remediated.

Finally, the Bureau intends to seek civil money penalties against 3D Resorts-Bluegrass resulting from ILSA violations related to its sale of Green Farm Resort lots. ILSA provides that, for "any person [who] knowingly and materially violates"[19] any provision of ILSA (or any rule, regulation, or order issued thereunder), the Bureau may obtain penalties of up to $1,000 for each violation, and for continuing violations, each day may constitute a separate violation. 15 U.S.C. § 1717a(a)(2). In the present case, 3D Resorts-Bluegrass and its agents marketed under the February 26, 2009 Property Report for over ten months; under the January 13, 2010 Property Report for over two months; and under the March 22, 2010 Property Report, which was simultaneously not in legal effect and contained misrepresentations, for over a year. 3D Resorts-Bluegrass and its agents made further misrepresentations regarding amenities, infrastructure, and historical price figures for over two years. And despite the April 19, 2011 Suspension Notice, over the course of three months, 3D Resorts-Bluegrass and its agents continued to market lots on the Resort Property with dozens of tours, various marketing events, and thousands of mailed advertisements. 3D Resorts-Bluegrass has still not remedied all of the deficiencies which

[19] ILSA defines "knowingly" as "having actual knowledge of or acting with deliberate ignorance of or reckless disregard of the prohibitions" under ILSA. 15 U.S.C. § 1717a(f). The regulations define "materially" to mean "in some significant degree." 24 C.F.R. § 30.10.

predicated its April 19, 2011 suspension. Moreover, at least one of the violations, 3D Resorts-Bluegrass' failure to file financial statements (charged as Count XVII), continues to this day. Under ILSA "the maximum penalty for all violations by a particular person during any 1-year period shall not exceed $1,000,000." *Id.* Pursuant to the Civil Money Penalty Inflation Adjustment Act, HUD revised that penalty to $1,100 per violation, up to $1,375,000 against any particular person within a one-year period. 24 C.F.R. § 30.55. [20] Similarly, the Consumer Financial Protection Act of 2010 provides for the imposition of civil money penalties.[21]

In addition, for "any person [who] knowingly and materially violates" any provision of ILSA (or any rule, regulation, or order issued thereunder), that statute separately provides for civil monetary penalties which "may not exceed $1,000 for each violation, except that the maximum penalty for all violations by a particular person during any 1-year period may not exceed $1,000,000." 15 U.S.C. § 1717a(a)(2). That subsection also provides that each violation "shall constitute a separate violation with respect to each sale or lease or offer to sell or lease," and that for continuing violations, "each day shall constitute a separate violation." *Id.* For determining the amount of the penalty under ILSA, factors include (1) the gravity of the offense; (2) prior history of offenses; (3) ability to pay the penalty; (4) public injury; (5) benefits received; (6) deterrence; and (7) other factors as determined by the Director in regulations. 15 U.S.C. § 1717a(a)(3).

[20] 15 U.S.C. § 1717a(a)(2) further provides that each violation "shall constitute a separate violation with respect to each sale or lease or offer to sell or lease," and that for continuing violations, "each day shall constitute a separate violation." The regulation provides identical language, *see* 24 C.F.R. **§** 30.55(b), (c), which is tracked in the Prayer for Relief section of the Notice of Charges.

[21] The CFPA requires any person who violates, through any act or omission, any provision of Federal consumer financial law to pay a civil penalty. The Act provides for three tiers of penalties depending upon the nature of the conduct at issue – up to $5,000 per day for any violation regardless of knowledge (Tier 1); up to $25,000 per day for recklessly engaging in a violation (Tier 2); and up to $1,000,000 per day for knowing violations (Tier 3). 12 U.S.C. § 5565(c)(2). ILSA expressly states that its CMPs "shall be in addition to any other available civil remedy, … and may be imposed whether or not the Director imposes other administrative sanctions." *Id.* § 1717a(a)(1).

Based on the lengthy and extensive pattern of fraudulent misrepresentations to purchasers and prospective purchasers, there is ample reason for the imposition of large civil penalties. 3D Resorts-Bluegrass engaged in the practice of making misrepresentations to potential purchasers from the first day they began selling lots on the Resort Property, and continued to do so for nearly two and a half years. As 3D Resorts-Bluegrass continued to market and sell lots on the Resort Property, the number of misrepresentation grew with respect to infrastructure and the amenities that would be available to lot owners. Even after the service of the Suspension Notice that prohibited the marketing and sale of lots, such activity continued on the Resort Property. The gravity of this conduct is evidenced, in part, by the hundreds of consumers affected, many of whom are currently obligated to pay outstanding balance on properties that (due to the lack of infrastructure and available amenities) have little value.

Despite 3D Resorts-Bluegrass being a debtor in a pending bankruptcy proceeding, this action (including the assessment of such penalties) is necessary to deter such conduct in the land sale industry. Allowing a wrongdoer to protect or insulate itself from the assessment of appropriate civil money penalties because it files a petition for bankruptcy may incentivize future wrongdoers to take a similar path.

IV. Conclusion

As the evidence at the hearing will show, the fraudulent and otherwise unlawful conduct of 3D Resorts-Bluegrass spanned several years and adversely affected hundreds of purchasers. Many of these lot owners are now left with tens of thousands of dollars of debt and an unbuildable piece of property worth barely a fraction of the amount of debt owed. Such misconduct warrants equitable relief to redress the harm suffered by consumers, and the imposition of significant civil money penalties to punish and to deter such conduct in the future.

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Certificate of Service

I certify that on this 7th day of August, 2013, I caused the foregoing **Prehearing Brief of the Consumer Financial Protection Bureau** to be filed and to be served upon the following parties by electronic service:

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