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16	UNITED STATES DISTRICT COURT			
17	CENTRAL DISTRICT OF CALIFORNIA			
18	SOUTHERN DIVISION			
19	·	1	SACV <sub>0</sub>	5-943 JVS (AN <sub>X)</sub>
20	SECURITIES AND EXCHANGE COMMISSION,	Case No.:		•
21		COMPLAINT FEDERAL SE	FOR VIOLA	ATIONS OF THE LAWS
22	Plaintiff,			
23	vs.			
24	SALVATORE FAVATA,			
25	Defendant.			
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Plaintiff Securities and Exchange Commission ("Commission") for its Complaint for Violations of the Federal Securities Laws ("Complaint") against Salvatore Favata ("Favata") alleges as follows:

### **JURISDICTION AND VENUE**

- 1. This court has jurisdiction over this action pursuant to sections 20(b) and 22(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77t(b) & 77v(a)], and Sections 21(d)(1), 21(e), and 27 of the securities exchange act of 1934 ("Exchange Act") [15 U.S.C. §§ 78u(d)(1), 78u(e) & 78aa]. The Defendant has, directly or indirectly, made use of the means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, in connection with the transactions, acts, practices and courses of business alleged in this complaint.
- 2. Venue is proper in this district pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)], and Section 27 of the Exchange Act [15 U.S.C. § 78aa], because the Defendant resides in the district and because certain of the transactions, acts, practices, and courses of conduct constituting violations of the federal securities laws occurred within this district.

#### **SUMMARY**

- 3. From late 2001 through March 2006 Favata, acting through National Consumer Mortgage, LLC ("NCM"), a real estate mortgage and investment company located in Orange, California, defrauded 233 investors out of more than \$30 million by offering and selling so-called "private money investment notes" ("notes").
- 4. Favata falsely told investors that their money would be used to fund high interest rate residential mortgage loans, that they would receive annual interest payments between 30-60 percent of their original investment, and that the loans underlying the notes would be secured by real property. In reality, Favata used investor funds to pay returns to existing investors in a Ponzi-scheme fashion,

to pay operating expenses of NCM's more conventional mortgage brokerage business and to pay Favata's gambling debts which amounted to more than \$10 million.

- 5. Defendant Favata, directly and indirectly, has engaged and, unless enjoined, will continue to engage in acts, practices and courses of business which constitute violations of the antifraud, registration and certain broker-dealer provisions of the federal securities laws [Sections 5(a), 5(c) and 17(a) of the Securities Act (15 U.S.C. §§ 77e(a), 77e(c), and 77q(a)) and Sections 10(b), 15(a) of the Exchange Act (15 U.S.C. §§ 78j(b), 78o(a), and 78o(c)) and Rule 10b-5 (17 C.F.R. § 240.10b-5) promulgated thereunder.]
- 6. The Commission seeks an injunction against future violations of the federal securities laws cited herein.

#### **DEFENDANT**

7. Favata, age 46, resides in Yorba Linda, California. Favata was the president of NCM's so-called "private money investment" division. NCM was a privately held limited liability company and licensed mortgage broker based in Orange, California. While Favata was NCM's chief operator, his wife and mother were the company's listed principals. Initially, Favata was excluded from any ownership or management role because of his prior felony conviction. On May 12, 2006, a Chapter 11 trustee was appointed to manage the ongoing operations of NCM. On June 26, 2006 the trustee terminated NCM's operations and sold its assets at auction.

## **FACTUAL ALLEGATIONS**

8. In December 2002 Favata commenced the operations of NCM's so-called "private money" division and devised a scheme to raise investor funds through the offer and sale of the notes purportedly to fund residential loans secured by real property. From its inception until March 2006, Favata raised over \$30 million from approximately 233 investors primarily located in California and

Colorado through the offer and sale of the notes ranging in terms from one to four years and promising returns of between 7 and 60 percent. Investors were told that they would be paid interest on a monthly basis and that their principal would be returned at the end of the term.

- 9. During the relevant period Favata solicited investors in face-to-face settings, including church gatherings and investment seminars, and also persuaded mortgage refinance clients to take cash out of their refinancing and use that cash to invest in NCM notes.
- 10. Favata falsely told potential investors that investor funds would be loaned by NCM to homeowners who could not qualify for traditional mortgages. Favata told investors that the return on the notes would be generated through the interest NCM received on the mortgage loans. Favata claimed that the notes were guaranteed by the real estate securing the underlying residential loans and that NCM only lends on properties that have a 65 percent or lower loan to value ratio ensuring a low default rate and the investors' principal in the event of a foreclosure. Favata also told potential investors that NCM maintained deeds of trust for the real estate securing the investments.
- 11. In addition to the oral solicitations, Favata drafted and distributed promotional materials that falsely described the investments as follows: a) since 1989 NCM investment plans have earned on average 10-14 percent per annum; b) NCM offers two investment plans consisting of retirement investments and short-term private real estate money notes; c) NCM investment plans provide monthly interest payments and return of the principal at the completion of the investment note term with an option to reinvest; d) NCM specializes in non-qualified and qualified retirement investment plans that yield a 10 percent rate of return per annum; e) all investments are secured by real property; and f) NCM receives 10-20 loan requests per week that range in value from \$25,000 to \$25 million.

12. In reality, the investor funds were almost never used to fund high interest rate mortgage loans secured by real property as represented to investors. Instead, a substantial amount of new investor money was used to pay returns to existing investors and to cover the operating cost of NCM's more conventional mortgage brokerage business. In addition, Favata made unauthorized cash withdrawals totaling approximately \$10.2 million from January 2004 to March 2006 primarily to cover gambling debts. Investor funds were also used to pay Favata's personal debts and monthly living expenses including, among other things, leased luxury vehicles, lavish house parties and community music festivals.

#### **COUNT I**

# OFFER AND SALE OF UNREGISTERED SECURITIES IN VIOLATION OF SECTIONS 5(a) AND 5(c) OF THE SECURITIES ACT

- 13. Paragraphs 1 through 12 are realleged and incorporated by reference as if set forth fully herein.
- 14. The NCM notes are securities within the meaning of Section 2(1) of the Securities Act [15 U.S.C. §§77b(1)].
- 15. Sections 5(a) and 5(c) of the Securities Act prohibit the sale of any security unless a registration statement is in effect with regard to that security, absent an applicable exemption from that requirement [15 U.S.C. §§77e (a) and (c)].
- 16. No registration statement has been filed with the SEC or is in effect with regard to any public offer or sale of the NCM securities at issue, and no exemption from registration is applicable to the offers or sales of those securities.
- 17. By the conduct described above, Defendant Favata, directly and indirectly, by making use of the means or instruments of transportation or communication in interstate commerce or of the mails to offer or sell securities, through the use or medium of a prospectus or otherwise, when no registration statement has been filed or was in effect as to such securities, engaged in

transactions, acts, practices, and courses of business that violated Sections 5(a) and 5(c) of the Securities Act [15 U.S.C. §§77e (a) and (c)].

#### **COUNT II**

# FRAUD IN VIOLATION OF SECTION 17(a)(1), (2) AND (3) OF THE SECURITIES ACT

- 18. Paragraphs 1 through 12 are realleged and incorporated by reference as if set forth fully herein.
- 19. At the times alleged in the Complaint, Defendant Favata, in the offer and sale of the securities described above, by the use of means and instruments of transportation and communication in interstate commerce and by the use of the mails, directly and indirectly, employed devices, schemes and artifices to defraud.
- 20. Defendant Favata, in the offer and sale of the securities described above, by the use of means and instruments of transportation and communication in interstate commerce, and by use of the mails, directly and indirectly, obtained money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.
- 21. Defendant Favata, in the offer and sale of the securities described above, by use of means and instruments of transportation and communication in interstate commerce, and by use of the mails, directly and indirectly, engaged in transactions, practices or courses of business which operated as a fraud and deceit upon purchasers and prospective purchasers as more fully described herein.
- 22. By the conduct described above, the defendant violated Sections 17(a)(1), (2) and (3) of the Securities Act [15 U.S.C. §77q(a)(1)-(3)].

#### **COUNT III**

# ACTING AS UNREGISTERED BROKER DEALER IN VIOLATION OF SECTION 15(a) OF THE EXCHANGE ACT

23. Paragraphs 1 through 12 are realleged and incorporated by reference as if set forth fully herein.

- 24. At the times alleged in the Complaint, Defendant Favata made use of the mails and means and instrumentalities of interstate commerce to effect transactions in, induce and attempt to induce the purchase and sale of the securities described herein, while not being registered with the Commission as a broker or dealer, and when no exemption from registration was available.
- 25. By the conduct described above, the defendant violated Section 15(a) of the Exchange Act [15 U.S.C. § 78o(a)].

### **COUNT IV**

# FRAUD IN VIOLATION OF SECTION 10(b)

#### OF THE EXCHANGE ACT AND RULE 10b-5 THEREUNDER

- 26. Paragraphs 1 through 12 are realleged and incorporated by reference as if set forth fully herein.
- 27. At the times alleged in the Complaint, Defendant Favata, directly and indirectly, by the use of means and instrumentalities of interstate commerce, and of the mails, knowingly employed devices, schemes and artifices to defraud in connection with the purchase and sale of the securities described herein.
- 28. Defendant Favata, directly and indirectly, by the use of means and instrumentalities of interstate commerce, and of the mails, made untrue statements of material fact and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading in connection with the purchase and sale of the securities described herein.
- 29. Defendant Favata, directly and indirectly, by the use of means and instrumentalities of interstate commerce, and of the mails, engaged in acts, practices, and courses of business which operated as a fraud and deceit upon the purchasers and sellers of the securities described herein.

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30. By the conducted described above, the defendant violated Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] promulgated thereunder.

#### PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

I.

Issue findings of fact and conclusions of law that the Defendant Favata committed the violations alleged above.

II.

Issue a judgment, in a form consistent with Fed. R. Civ. P. 65(d), permanently enjoining Defendant Favata, his officers, agents, servants, employees, attorneys and those persons in active concert or participation with them who receive actual notice of the injunction by personal service or otherwise, from violating Sections 5(a), 5(c), and 17(a) of the Securities Act [15 U.S.C. §§ 77e(a), 77e(c), and 77q(a)] and Sections 10(b) and 15(a) of the Exchange Act [15 U.S.C. §§ 78j(b), 78o(a), and 78o(c)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] promulgated thereunder.

III.

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

# IV.

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

Dated: October 5, 2006

Respectfully submitted,

ROBERTO A. TERCERO

Attorneys for Plaintiff
Securities and Exchange Commission