SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Release No. 10219 / September 21, 2016

SECURITIES EXCHANGE ACT OF 1934
Release No. 78898 / September 21, 2016

INVESTMENT COMPANY ACT OF 1940
Release No. 32279 / September 21, 2016

Admin. Proc. File No. 3-16498

In the Matter of

RUSSELL C. SCHALK, JR.

OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

Respondent sold securities in two entities he controlled in unregistered transactions when no exemption from registration was available, and made material misrepresentations and failed to disclose material facts to investors in connection with those sales. Respondent consented to entry of an order imposing disgorgement, prejudgment interest, and a civil penalty, and instituting proceedings to determine his ability to pay. *Held*, it is in the public interest to order Respondent to pay $20,000 per year towards the disgorgement, prejudgment interest, and civil money penalty amounts to which he agreed.

APPEARANCES:

Russell C. Schalk, Jr., pro se.

John J. Bowers, for the Division of Enforcement.

Appeal filed: March 9, 2016
Last brief received: July 19, 2016

I. BACKGROUND

Russell C. Schalk, Jr. ("Schalk") appeals from the initial decision of an administrative law judge[1] finding that he can pay $20,000 per year to satisfy a Commission order entered with his consent requiring that he pay disgorgement plus prejudgment interest and a civil money penalty ("Order").[2] Schalk is the sole control person and one-third owner of Raintree Racing, LLC ("Raintree Racing") and the sole control person, president, CEO, and secretary-treasurer of Raintree Thoroughbred Farm, Inc. ("Raintree Farm"). The Order found that Schalk sold over $2 million in Raintree Racing and Raintree Farm securities through unregistered offerings when no exemption from registration was available and made material misrepresentations and failed to disclose material facts to investors in those securities.

With respect to the Raintree Racing securities sales, Schalk misled investors when he told them that they would receive a 20% return and that their invested principal would be returned in one year or less. Without authorization from or informing investors, Schalk transferred $668,000 from Raintree Racing to Raintree Farm to pay Raintree Farm's expenses, substantially reducing the likelihood that Raintree Racing investors would receive the payments Schalk promised. With respect to Raintree Farm, Schalk sent his investors misleading account statements that stated that Raintree Farm's net asset value was $3.34 per share when he admittedly had no basis for that valuation. Schalk also failed to tell the Raintree Farm investors that Raintree Farm had operated at a loss since its inception in 2002, had minimal assets, and relied on money from Raintree Racing to fund its operations. The Order also found that Schalk transferred $220,000 from Raintree Racing and Raintree Farm to himself, without telling investors or obtaining authorization.[3]

The Order found that Schalk willfully violated Sections 5(a) and 5(c) of the Securities Act, which prohibit the sale of securities in unregistered offerings when no exemption from registration is available, and Section 17(a) of the Securities Act and Section 10(b) of the

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[1] *Russell C. Schalk, Jr.*, Initial Decision Release No. 958, 2016 WL 536129 (Feb. 10, 2016).

[2] *Russell C. Schalk, Jr.*, Securities Act Release No. 9751, 2015 WL 1745864 (Apr. 17, 2015).

[3] Schalk's petition for review and brief include his request, "for the purpose of clarification only," that we provide "an explanation regarding the $220,000 in funds the [Order] recites that [Schalk] diverted [from Raintree Racing and Raintree Farm] without authorization." Schalk admits that he transferred the $220,000 to himself, but claims that he and his attorney were the "only two officers of the company" and it is therefore "unclear to [Schalk]" from whom he "needed to receive authorization in order to recover funds [Schalk] initially lent the company." Schalk agreed in the Order that he would not challenge its factual findings, and the Order includes the finding that he diverted the $220,000 "without the knowledge or authorization of Raintree Farm and Raintree Racing investors."

Exchange Act and Rule 10b-5 thereunder, which make it unlawful to make misleading statements or omissions of material fact in connection with securities transactions.[4]

In the Order, Schalk consented to: (i) the Order's findings of fact and conclusions of law, but solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party;[5] (ii) cease and desist from committing or causing any violations and any future violations of the provisions of the securities laws that he violated; (iii) a prohibition from serving or acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, or that is required to file reports pursuant to Section 15(d) of the Exchange Act; (iv) a prohibition from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and (v) his liability for disgorgement of $1,472,959, prejudgment interest of $280,271.55, and a third tier civil penalty of $1,600,000, subject to additional proceedings to determine his ability to pay.[6] Schalk further agreed in the Order that in such additional proceedings: (i) he would be precluded from arguing that he did not violate the federal securities laws described in the Order; (ii) he could not challenge the validity of the Order, including amounts lost by investors and misappropriated by Schalk; (iii) solely for the purposes of such additional proceedings, the allegations of the Order shall be accepted as and deemed true; and (iv) the administrative law judge could determine Schalk's ability to pay on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.[7]

In the subsequent additional proceedings to determine his ability to pay, Schalk agreed to forego an in-person hearing and submitted a sworn financial disclosure statement with an attached explanation and his tax returns from tax years 2007 through 2014. This information showed he had an annual salary of $65,000 and an additional $26,543 in commissions for the twelve-month period ending in June 2015. Both Schalk and the Division of Enforcement also submitted briefs. Based on this record, an administrative law judge found that Schalk "could expect to earn [in the future] at least $20,000 in commissions each year" from his current employer. The ALJ therefore found that Schalk had the ability to pay $20,000 per year towards the disgorgement, prejudgment interest, and civil money penalty amounts imposed by the Order.

We base our findings on an independent review of the record, except with respect to the findings determined conclusively in our Order and those additional findings not challenged on appeal. As part of his petition for review, Schalk submitted a sworn financial statement and

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4 15 U.S.C. §§ 77e(a), 77e(c), 77q(a), 78j(b); and 17 C.F.R. § 240.10b-5.

5 Schalk neither admitted nor denied the findings in the Order, except that he admitted the findings as to the Commission's jurisdiction over him and over the subject matter of these proceedings. *Schalk*, 2015 WL 1745864, at *1.

6 *Id.* at *11.

7 *Id.*

accompanying supporting documentation which were nearly identical to the submissions he made below.[8] We find that the Initial Decision correctly determined Schalk's ability to pay.

II. ABILITY TO PAY

Schalk contends that the initial decision wrongly determined his ability to pay, and we address each of Schalk's arguments below, none of which persuade us that he is unable to pay $20,000 a year towards the amounts he owes.

A. Schalk's Vehicle Costs

Schalk disputes the initial decision's characterization of his personal automobile as "what most people would view as a luxury vehicle," and the initial decision's consequent determination that it was appropriate to "disregard half the amount of Schalk's [automobile] lease" in determining his ability to pay. According to Schalk, his vehicle is not a luxury vehicle and his relatively high lease payments are a result of his poor credit history. The Division responds that "Schalk's explanation that the high lease payment is based on his poor credit history does not change the fact that he could use mass transit or drive a less expensive car and apply the savings to repaying injured investors." We agree with the initial decision's finding that "[c]rediting the cost of an [expensive] vehicle against Schalk's obligations would effectively encourage people in Schalk's situation to spend extravagantly." Counting only half of the automobile lease amount when considering Schalk's ability to pay is a reasonable approach.

B. Schalk's Credit Card Debt and Other Expenses

Schalk also asserts that his credit card debt, which he claims is "not due to vacations, gambling, or any sort of extravagant spending as erroneously concluded by the ALJ," supports his claim of inability to pay. But the law judge stated only that he would not consider Schalk's credit card debt "on the question of his ability to pay" because Schalk "provided no evidence concerning what he purchased when he incurred his credit card debt." Schalk points to no specific language in the initial decision to support his claim that the law judge found he had engaged in "extravagant spending," and we find none.

In any case, Schalk submitted his recent credit card statements including detailed information regarding his purchases in connection with the sworn financial statements he filed as part of his petition for review. We have, in our discretion, reviewed those statements even though Schalk did not submit them below. The Division states that those statements include

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[8] As he did below, Schalk sought a protective order for the personal information in his submissions. On July 8, 2015, the ALJ issued an order specifying that Schalk's "personally identifiable information, including items such as account numbers and social security number, should be protected from the public." *Russell C. Schalk, Jr.*, Admin. Proc. Rulings No. 2907, 2015 SEC LEXIS 2787 (ALJ July 8, 2015). We likewise grant Schalk's request for a protective order against the disclosure of his account numbers and social security number, and similar personally identifiable information. *See* 17 C.F.R. § 201.322.

thousands of dollars in charges that "appear to be . . . extravagant." Schalk provides no explanation for these charges, and our review of the credit card account statements he submitted indicates that some of his credit card debt includes charges beyond ordinary, day-to-day living expenses, such as thousands of dollars spent at Pimlico Race Course. We find that such debts should not be considered in evaluating a respondent's ability to pay disgorgement to harmed investors, prejudgment interest, and civil money penalties.[9]

Schalk further claims that he has recently incurred increasing medical expenses, for which he has had to pay out-of-pocket amounts not covered by his health insurance. But he provides no evidence to support this claim. Because Schalk has not met his burden of proof with respect to such expenses, we cannot factor them into our consideration of his ability to pay.[10]

C. Schalk's Earning Capacity

Schalk contests the initial decision's finding that it "is more likely than not that [Schalk] will earn commissions in the future" from his current employer, Incentus International LLC, where he is a Vice President of Sales. Schalk claims that the "ALJ overlooked that [Schalk] earned no commissions in 2014, and limited commissions in 2015." Schalk also claims that his financial situation is so dire that he has had to take numerous loans from his employer in recent years as an advance on future commissions, and he has attached certain evidence to support this claim, most of which he also submitted below with certain additional evidence for newer loans.

We have reviewed the evidence Schalk submitted regarding loans from his employer. It does not include account information or evidence that any funds were actually received or deposited. As to commissions, the initial decision stated that Schalk had "supplied no information relating to whether he has received commissions in 2015" and the "fact that Schalk earned commissions in the past and likely will in the future suggests that last year was an aberration." The initial decision therefore did not overlook Schalk's past commission-earning history in evaluating his ability to pay. Schalk's sworn financial statements submitted as part of his petition for review, moreover, show that he has recently earned significant commissions. They show commissions totaling $24,331, in addition to his $65,000 annual salary, for the twelve-month period ending in March 2016; this indicates a likelihood that Schalk will continue to earn commissions in the future. Indeed, Schalk concedes in his brief that the law judge "correctly concluded that [Schalk] should make $20,000 in commissions each year as an average."

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9 *Cf. Michael Albert Dipietro*, Exchange Act Release No. 77398, 2016 WL 1071562, at *5 (Mar. 17, 2016) (sustaining FINRA's determination that respondent had failed to establish a bona fide inability to pay an arbitration award because respondent "chose to pay . . . discretionary expenses instead of paying down the balance of the arbitration award").

10 *Cf. SEC v. Huffman*, 53 F.3d 1280, 1995 WL 2955849, at *3 (5th Cir. 1995) (unpublished) (finding that respondent "had failed to prove an inability to pay the disgorgement by a preponderance of the evidence" because "all the evidenced in the record concerning [respondent's] liabilities is unsubstantiated and self-serving").

Schalk also claims that it is "an error of fact" that the Division "contends that [Schalk] continue[s] to operate Raintree . . . Farm." For the first time, he submits a letter regarding Raintree Farm's March 2016 final tax statements as evidence that the business is no longer operational. The Division, contrary to Schalk's suggestion, merely argued in its opposition brief that it "remain[ed] unclear" whether Schalk operated Raintree Farm. It cites that entity's 2014 tax return, which Schalk submitted below, indicating ongoing operations. In any event, the operation or non-operation of Raintree Farm played no role in the initial decision's determination regarding Schalk's ability to pay, nor have we considered it as a factor in our review on appeal.

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The weight of the evidence leads us to conclude that the initial decision's finding that Schalk has the ability to pay $20,000 per year, based partly on the likelihood of his earning future commissions and partly on Schalk's ability to reduce his personal expenses, was correct.

III. THE PUBLIC INTEREST

Under Rule of Practice 630(a), we have discretion to consider evidence of ability to pay in determining whether disgorgement, prejudgment interest, or a civil penalty is in the public interest.[11] "Ability to pay, however, is only one factor that informs our determination and is not dispositive."[12] "It is well settled that an applicant bears the burden of demonstrating the inability to pay."[13] We conclude that Schalk has not demonstrated that he is unable to pay $20,000 per year towards the disgorgement, prejudgment interest, and civil penalty amounts to which he consented. The evidence suggests that the initial decision's determination reflected a reasoned evaluation of the documentation that Schalk himself submitted, and the limited additional documentation that Schalk submitted on appeal does not support a reduction of this amount.

In evaluating the public interest, we are "cognizant of the inadvisability of assessing penalties so heavy that the persons against whom they are assessed are unable to pay them. Such a situation results in the expenditure of agency resources in unsuccessful attempts to collect the penalties. Moreover, the imposition of a [penalty] that cannot be enforced may ultimately render the deterrent message intended to be communicated by the [penalty] less meaningful."[14]

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11 17 C.F.R. § 201.630(a).

12 *Gregory O. Trautman*, Securities Act Release No. 9088A, 2009 WL 6761741, at *24 (Dec. 15, 2009) (citations omitted); *see also, e.g., SEC v. Warren*, 534 F.3d 1368, 1370 (11th Cir. 2008) (per curiam) (stating that "[a]t most" a defendant's ability to pay is one factor to be considered in imposing a civil money penalty or disgorgement).

13 *Steven E. Muth and Richard J. Rouse*, Exchange Act Release No. 52551, 2005 WL 2428336, at *19 (Oct. 3, 2005) (citations omitted).

14 *Philip A. Lehman*, Exchange Act Release No. 54660, 2006 WL 3054584, at *9 & n.40 (Oct. 27, 2006); *but see Charles Trento*, Exchange Act Release No. 49296, 2004 WL 329040, at *4 (Feb. 23, 2004) ("Even accepting Trento's financial report at face value, we find that the egregiousness of his conduct far outweighs any consideration of his present ability to pay. . . .").

As discussed above, we have carefully reviewed the sworn financial statements and other documentation that Schalk has submitted. Those sworn financial statements indicate that Schalk's liabilities exceed his assets by nearly $200,000. Although Schalk's liabilities may currently exceed his assets, we believe that his future income, including the likelihood of earning commissions in addition to his $65,000 annual salary, and adjustments to his spending habits would enable him to make the $20,000 payments on an annual basis. We have also held that "when conduct is 'sufficiently egregious,' the Commission may impose a sanction despite a demonstrated inability to pay."[15] Based on our review, we agree with the initial decision that requiring Schalk to pay $20,000 per year towards the disgorgement, civil money penalty, and prejudgment interest amounts to which he consented in the Order is in the public interest.

An appropriate order will issue.[16]

By the Commission.

Brent J. Fields
Secretary

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[15] *Thomas C. Bridge*, Exchange Act Release No. 60736, 2009 WL 3100582, at *25 (Sept. 29, 2009) (quoting *Lehman*, 2006 WL 3054584, at *4).

[16] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
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In the Matter of

RUSSELL C. SCHALK, JR.

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Russell C. Schalk, Jr. be ordered to pay $20,000 per year towards his liabilities for disgorgement of $1,472,959.00, a civil money penalty of $1,600,000.00, and prejudgment interest of $280,271.55.

Payment of the amounts to be disgorged and the civil money penalties shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South MacArthur Blvd., Oklahoma City, OK 73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

By the Commission.

Brent J. Fields
Secretary