SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 71340 / January 17, 2014

Admin. Proc. File No. 3-15259

In the Matter of the Application of

CAPWEST SECURITIES, INC.
c/o H. Thomas Fehn, Esq.
Fields, Fehn & Sherwin
1175 Wilshire Boulevard, 15th Floor
Los Angeles, CA 90025

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DISCIPLINARY PROCEEDING

Failure to Comply with Advertising Rules

Failure to Supervise

Conduct Inconsistent with Just and Equitable Principles of Trade

Former member firm of registered securities association violated content standards applicable to communications with the public, in that the communications: (1) were not fair and balanced and failed to provide a sound basis for evaluating the products and services being promoted; (2) used exaggerated and/or misleading statements; (3) used prohibited statements projecting results of the services or products being promoted; and (4) used customer testimonials without the requisite disclosures. Former member firm also violated supervisory standards by failing to implement effectively the firm's supervisory procedures. As a result of these violations, former member firm engaged in conduct inconsistent with just and equitable principles of trade. *Held*, association's findings of violations and the sanctions it imposed are *sustained*.

APPEARANCES:

H. Thomas Fehn, *Gregory J. Sherwin*, and *Orly Davidi*, of *Fields, Fehn, & Sherwin*, for CapWest Securities, Inc.

Alan Lawhead, *Andrew Love*, and *Gary J. Dernelle*, for the Financial Industry Regulatory Authority, Inc.

Appeal filed: March 29, 2013
Last brief received: June 21, 2013

I.

CapWest Securities, Inc., formerly a FINRA member firm,[1] seeks review of FINRA disciplinary action. FINRA found that, during the period from October 1, 2006 to March 31, 2007, CapWest violated NASD Conduct Rules 2210 and 2110 through its use of violative public communications,[2] for which FINRA fined CapWest $25,000 and censured the Firm. FINRA

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[1] CapWest became a FINRA member in 1992. The Firm's headquarters were in Lakewood, Colorado, and it maintained thirty branch offices with forty-five total registered representatives nationwide. On September 23, 2011, FINRA cancelled CapWest's registration because of the Firm's failure to pay outstanding fees, and the Firm is no longer in business. CapWest filed a brief in support of its appeal, but never filed a reply brief, as permitted by the briefing order.

[2] On July 26, 2007, the Commission approved a proposed rule change that NASD filed seeking to amend its Certificate of Incorporation to reflect its name change to the Financial Industry Regulatory Authority, Inc. ("FINRA"), in connection with the consolidation of its member firm regulatory functions with NYSE Regulation, Inc. *See* Securities Exchange Act Release No. 56148, 2007 SEC LEXIS 1648 (July 26, 2007). Following the consolidation, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* Exchange Act Release No. 58643 (Sept. 25, 2008), 73 Fed. Reg. 57,174 (Oct. 1, 2008).

NASD Conduct Rule 2210 set forth content standards for member communications with customers or the public. On March 29, 2012, the Commission approved new FINRA rules governing member firm communications with the public, consolidated in FINRA Rule 2210, which became effective February 4, 2013. The new rules do not alter, in any material respect, the standards that FINRA applied in this case. *See FINRA Regulatory Notice 12-29*, 2012 FINRA LEXIS 36, at *40-43 (June 2012).

NASD Conduct Rule 2110 required members to "observe high standards of commercial honor and just and equitable principles of trade" in the conduct of their business. In September 2008, the Commission approved the new FINRA Rule 2010, which replaced NASD Rule 2110. The new rule, which became effective December 15, 2008, does not alter, in any material respect, the prior rule. *See FINRA Regulatory Notice 08-57*, 2008 FINRA LEXIS 50 (Oct. 2008).

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further found that CapWest failed to implement its supervisory system effectively with regard to reviewing the communications at issue, in violation of NASD Conduct Rules 3010 and 2110,[3] for which FINRA fined CapWest $25,000.[4] We base our findings on an independent review of the record.

II.

A. Section 1031 Exchanges and TIC investments proliferated in the early 2000s, prompting NASD to issue *Notice to Members 05-18*.

This matter relates to public communications that CapWest used to promote tax-deferred exchanges of real property under Section 1031 of the Internal Revenue Code ("Section 1031 Exchanges"), as well as tenancy-in-common ("TIC") investments. Section 1031 of the IRC permits an investor to defer paying capital gains tax otherwise due on the sale of real estate held for productive use in a trade or business or for investment by exchanging the investment for "like-kind" property of equal or greater value.[5] One of the ways that a Section 1031 Exchange can be accomplished, subject to certain requirements, is through a TIC, in which an investor obtains an undivided fractional interest in real property.[6]

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FINRA's disciplinary action here was instituted after the consolidation of NASD and NYSE, but the conduct at issue took place before the relevant consolidated rules took effect. Accordingly, NASD conduct rules apply.

[3] NASD Conduct Rule 3010 required, among other things, that members "establish and maintain a system to supervise the activities of" registered representatives and other associated persons "that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules." In July 2013, FINRA noticed a proposed new consolidated rule regarding supervision. Exchange Act Release No. 69902 (July 1, 2013), 78 FR 40792 (July 8, 2013) (Notice of Filing of a Proposed Rule Change to Adopt Rules Regarding Supervision in the Consolidated FINRA Rulebook).

[4] FINRA also assessed hearing costs in the amount of $2,867.75.

[5] 26 U.S.C. § 1031(a)(1).

[6] In a typical TIC, the profits (if any) are derived mostly through the efforts of the sponsor and the management company, which manage and lease the acquired property. *NASD Notice to Members 05-18*, 2005 NASD LEXIS 25, at *6 (Mar. 2005). The sponsor also ordinarily structures the TIC, including the up-front fees and expenses charged to the tenants-in-common, and negotiates the sale price and loan for the acquired property. *Id*. A TIC, standing alone, would not ordinarily constitute a security. *See id.*, at *6 n.5. But when a TIC is sold by a sponsor pursuant to a contractual arrangement and involves pooling assets and sharing the risks and rewards of the investment with other tenants-in-common, this generally constitutes an investment contract and, thus, a security. *See, e.g.*, *SEC v. Edwards*, 540 U.S. 389, 394 (2004) (defining "investment contract" as depending on "whether the scheme involves an investment . . . with profits to come solely from the efforts of others" (citing *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946)); *Anthony H. Barkate*, Exchange Act Release No. 49542, 2004 SEC LEXIS 806, at *10 (Apr. 8, 2004) (finding "an investment in a common enterprise with a reasonable

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The sales volume of TICs grew significantly during the early 2000s, from approximately $150 million in 2001 to approximately $2 billion in 2004.[7] Given the growth in use of these products and some of the risks involved in TIC investments, NASD issued *Notice to Members 05-18*, which noted that TICs are illiquid investments for which no secondary market exists and that subsequent sales of the investment property may occur at a discount to the value of the real property interest underlying the TIC.[8] NASD further pointed out the risk that the fees and expenses charged by the TIC sponsor have the potential to outweigh the tax benefits associated with a Section 1031 Exchange.[9] NASD warned its members of their obligation to comply with all applicable conduct rules when selling TICs, specifically highlighting the obligation to "ensure that promotional materials used by the member are fair, accurate, and balanced."[10]

B. FINRA Advertising Regulation conducted a sweep of certain member firms' public communications related to the sale of TICs, including those of CapWest, resulting in disciplinary proceedings.

Approximately two years after the issuance of *Notice to Members 05-18*, FINRA's Department of Advertising Regulation conducted a "sweep," in which it requested that a group of thirty member firms, including CapWest, produce all of the public communications the firms used in promoting 1031 Exchanges and TICs during the six-month period from October 2006 through March 2007 (the "Sweep Period").[11] In response to the sweep, CapWest produced 268 documents, which took multiple forms, including newsletters, websites, seminar presentations, newspaper and magazine advertisements, form letters, a radio interview script, brochures, and postcards. After reviewing the materials CapWest submitted, Advertising Regulation referred the Firm to FINRA's Department of Enforcement for disciplinary action. On March 4, 2010, FINRA's Department of Enforcement filed a complaint against CapWest, charging that 166 of the 268 communications violated NASD conduct rules regarding public communications and that the Firm had violated NASD's supervisory standards with respect to the communications at issue. On April 12, 2011, a FINRA Hearing Panel conducted a one-day hearing.

FINRA presented its case through a single witness, J. Martin Levine, the FINRA Advertising Regulation investigator responsible for reviewing the communications CapWest submitted in response to the sweep. Levine testified with respect to the procedures FINRA followed in conducting the sweep, and he reviewed the communications at issue to explain the

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expectation of profits to be derived from the entrepreneurial efforts of others" to be an investment contract).

7 2005 NASD LEXIS 25, at *4.

8 *Id*. at *10.

9 *Id.* at *11.

10 *Id.* at *8.

11 During the Sweep Period, CapWest sold 111 TIC securities to its customers, for a total value of $31.6 million.

basis for the proceeding. FINRA also introduced each of the allegedly violative communications as hearing exhibits. As CapWest stipulated, at the time of the sweep, its "supervisory system required registered representatives to submit proposed advertisements and sales literature to the firm's Compliance Department and obtain approval for those materials prior to use," and "CapWest supervisory personnel approved all of the 166 pieces of advertising and sales literature related to TICs . . . filed in this disciplinary proceeding."[12]

CapWest also presented only one witness, its president and chief executive officer, who testified regarding his purchase of the Firm around the time of the violations, and about the remedial steps the Firm subsequently took to comply with the applicable conduct rules. Among other things, the CEO conceded that he was not fully aware of "what the rules were" with respect to advertising content until the time of the sweep, after which the Firm attempted to "get things done the right way."[13] The Hearing Panel found that CapWest had committed the violations as charged in the complaint, censured CapWest, and fined the Firm $150,000 for the content standards violations.

CapWest did not appeal the Hearing Panel's decision. FINRA's National Adjudicatory Council ("NAC"), however, called the matter to review the appropriateness of the fine the Hearing Panel imposed for the Rule 2210 and 2110 violations.[14] The NAC determined that the $150,000 fine was excessive because, it found, a majority of the violations were "inadvertent" and the result of a systemic problem in the Firm's implementation of its supervisory system, many of the communications were targeted to accredited investors, and several of the communications were repeated multiple times in identical form. As a result, the NAC reduced the fine from $150,000 to $25,000. The NAC further affirmed the Hearing Panel's findings that CapWest violated Rules 3010 and 2110 by failing to implement effectively its supervisory procedures, in that all 166 violative communications were approved by supervisory personnel of the Firm. The NAC found that, while CapWest "reasonably designed" its supervisory system to ensure compliance—and it was undisputed that the Firm's supervisory personnel reviewed the violative communications—the Firm "did not provide [its] principals, or the Firm's registered representatives, with adequate training and guidance concerning these standards." It also

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[12] The Firm's Written Supervisory Policies and Procedures regarding communications with the public, in effect at the time of the sweep, stated, "The [CapWest] Home Office or your [Office of Supervisory Jurisdiction] must pre-approve and receive final copies of ***ALL*** advertising done by registered representatives." (Emphasis in original.)

[13] Some of the new procedures CapWest implemented after the sweep included tracking each individual piece of advertising, hiring a new compliance officer experienced with the advertising rules, sending the compliance officer to FINRA's annual advertising conferences, and tasking the compliance officer with ensuring that all communications with the public contain the appropriate disclosures identified by FINRA examiners in the sweep.

[14] FINRA Rule 9312 authorizes the NAC to call for review on its own motion the disciplinary decisions of a FINRA hearing panel. Both parties submitted briefs and appeared at oral argument before the NAC.

affirmed the $25,000 fine the Hearing Panel imposed for the supervisory violations.[15] CapWest subsequently filed this appeal.[16]

III.

NASD Rule 2210(d)(1) contained conduct standards applicable to all member firm communications with the public, including the requirements that such communications: (i) "shall be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service;"[17] (ii) shall not contain "any false, exaggerated, unwarranted or misleading statement or claim;"[18] and (iii) "may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast."[19] Rule 2210(d)(2) required that advertisements or sales literature "providing any testimonial . . . must prominently disclose . . . : (i) the fact that the testimonial may not be representative of the experience of other clients; [and] (ii) the fact that the testimonial is no

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[15] CapWest did not appeal the Hearing Panel's decision to the NAC, nor did the NAC call for review on its own motion the portion of the Hearing Panel's decision in which it found Rule 3010 violations and imposed sanctions for those violations. Nonetheless, the NAC determined to "address [the supervisory] issues . . . to provide the parties with a final FINRA decision that addresses all aspects of the case."

[16] FINRA claims that CapWest "waived all claims to contest the Hearing Panel's findings that the Firm violated FINRA rules [by failing to appeal the Hearing Panel's decision to the NAC]." It is, however, the decision of the NAC, not the Hearing Panel, that is before us on appeal. In any event, when affirming a final FINRA disciplinary action, we must determine whether the FINRA member engaged in the acts or practices found by FINRA, and whether those acts or practices violated FINRA's Rules. *See* 15 U.S.C. § 78s(e)(1)(A) (directing the Commission to affirm FINRA disciplinary sanctions if it finds, among other things, that the applicant "has engaged in such acts or practices . . . as the self-regulatory organization has found him to have engaged in [and] that such acts or practices . . . are in violation of such provisions of . . . the rules of the self-regulatory organization").

[17] NASD Rule 2210(d)(1)(A). This subsection of the Rule further states, "No member may omit any material fact or qualification if the omission, in light of the context of the material presented, would cause the communications to be misleading."

[18] NASD Rule 2210(d)(1)(B).

[19] NASD Rule 2210(d)(1)(D). This provision permits "a hypothetical illustration of mathematical principles . . . provided that it does not predict or project the performance of an investment or investment strategy."

guarantee of future performance or success."[20] FINRA found that CapWest violated NASD Rules 2210(d)(1) and 2210(d)(2), as well as NASD Rule 2110.[21]

FINRA found that some of the communications violated multiple NASD Rule provisions, for multiple reasons, while other communications violated only one provision. The following discussion analyzes CapWest's violative communications under each of the FINRA Rule provisions at issue.[22]

A. CapWest violated NASD Rules 2210(d)(1)(A) and 2110 because certain communications promoted the use of Section 1031 Exchanges or TICs without including an explanation of their features or without any mention of the potential risks, including the lack of liquidity, involved in TIC investments.

We sustain FINRA's findings that 154 of CapWest's 166 violative communications violated NASD Rules 2210(d)(1)(A) and 2110.[23] Certain communications promoted the use of 1031 Exchanges or TICs without providing a sound basis for evaluating the facts regarding them, as required by NASD Rule 2210(d)(1)(A).[24] For example, a CapWest registered representative in San Luis Obispo, California, used an advertisement in real estate industry publications on four occasions during the Sweep Period,[25] which included a photograph of pieces on a chess board with the question, "What's Your Next Move?" in large bold type. The advertisement stated in large print, "1031 Exchanges might just be the best kept secret in the Internal Revenue Code." It also touted several benefits of 1031 Exchanges. The advertisement did not, however, include

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[20] NASD Rule 2210(d)(2)(A)(i) and (ii).

[21] We have held that a violation of another NASD rule constitutes a violation of NASD Rule 2110. *See, e.g.*, *Stephen J. Gluckman*, Exchange Act Release No. 41628, 54 SEC 175, 1999 SEC LEXIS 1395, at *22 (July 20, 1999).

[22] The specific communications that we have found violative, which mirror those found by FINRA, are listed in the attached Appendix.

[23] Specifically, 127 of the 154 communications referenced, in a promotional manner, 1031 Exchanges without providing any explanation of their workings and features; 84 of the 154 communications referenced TICs without providing an explanation of their workings and features; and 126 of the 154 communications promoted positive features of TICs without including a balancing disclosure regarding the potential risks of such investments. At least one of these failures applied to each of the 154 communications.

[24] *See Pac. On-Line Trading & Sec., Inc.*, Exchange Act Release No. 48473, 56 SEC 1111, 2003 SEC LEXIS 2164, at *14 (Sept. 10, 2003) (holding that member firm's statement on its website that the firm provided the "fastest access to the market today" violated Rule 2210(d)(1)(A) because, without additional information, "it did not provide a basis for investors to evaluate the assertion").

[25] CX-42-CX-45. Each of the 166 communications that FINRA found violated NASD Rules was introduced as a hearing exhibit by FINRA's Department of Enforcement. We refer to them by their exhibit numbers, which are designated as "CX-__."

any discussion of how 1031 Exchanges work or the requirements for a given investment to qualify as a like-kind exchange.

Other CapWest communications promoted positive features of TICs in a way that was not fair and balanced, as required under NASD Rule 2210(d)(1)(A).[26] For example, one advertisement was published in identical form seventeen separate times in regional magazines, including *BrokerAgent*, *Haven*, *Central Coast*, and *Vintages*, a wine magazine.[27] It showed a photograph of a man and woman smiling as they open their home mailbox. The text reads, "I used to manage my investment property . . . now I manage my mailbox." The advertisement touts the "simplicity" of TIC investments, as well as their ability to "eliminate time intensive property management burdens associated with being a landlord." But the advertisement does not mention any of the negative attributes of such investments. Under NASD Rule 2210(d)(1)(A), sales literature used by member firms must "disclose in a balanced way the risks and rewards of the touted investment."[28] For example, the risk inherent in illiquid investments, such as the TIC investments being promoted here, must be disclosed,[29] as well as a downside risk analysis to balance statements about the investment's rewards.[30] Touting the benefits of the TIC investments without a balanced presentation of the risks entailed in the investment renders the communications misleading under NASD Rules.[31] The record here supports FINRA's finding

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[26] Some such risks, as discussed in *Notice to Members 05-18*, include the illiquidity of TIC securities (and the lack of a secondary market for such investments), the investor's loss of day-to-day control over property management decisions, the constraints resulting from the need for approval by other tenants-in-common regarding significant issues, such as upgrades or refurbishments to the property, the potentially significant management fees associated with a sponsored TIC investment, and the risk of loss of the principal invested. As Levine testified, "When you get into securitized tenant-in-common [investments], you don't have a direct say over day-to-day property management decisions. So if somebody wants to paint the building or something and cause you $30-80,000 in paint costs or something like that, if a majority votes on it, then it's done."

[27] CX-12-CX-29.

[28] *Jay Michael Fertman*, Exchange Act Release No. 33479, 51 SEC 943, 1994 SEC LEXIS 149, at *17 (Jan. 14, 1994). In order for an advertisement to be considered fair and balanced, it must include disclosure of relevant risks, including the risk of loss from the investment. *Pac. On-Line*, 2003 SEC LEXIS 2164, at *13-14 (citing *Fertman*).

[29] *Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 SEC LEXIS 2631, at *12 (Nov. 8, 2006) (finding that advertisement, which touted the "solid growth" and "reliable income" of certain notes, was misleading and violated Rule 2210 because it did not disclose the risks caused by the illiquidity of the investments).

[30] *Philip L. Spartis*, Exchange Act Release No. 64489, 2011 SEC LEXIS 1693, at *29-30 (May 13, 2011) (finding a violation of NASD Rule 2210(d)(1)(A) where the firm "fail[ed] to include any downside risk analysis").

[31] *See Excel Fin., Inc.*, Exchange Act Release No. 39296, 53 SEC 303, 1997 SEC LEXIS 2292, at *16 (Nov. 4, 1997) (noting two-page summary's failure to include discussion of "the

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that CapWest failed to provide the requisite balanced disclosure of the risks associated with TIC investments.

B. CapWest violated NASD Rules 2210(d)(1)(B) and 2110 by using communications that made exaggerated claims pertaining to the protection afforded to TIC investors by regulatory oversight or the tax benefits of 1031 Exchanges.

We sustain FINRA's findings that nine of the communications used by CapWest violated Rule 2210(d)(1)(B)'s prohibition against exaggerated or false and misleading claims. Six of these communications exaggerated the protection and security that TIC investors could expect as a result of regulatory oversight of the TIC industry. The advertisements in question described oversight by the Commission and other regulatory authorities as "an added benefit for investors" and suggested that oversight "guides [TIC sponsors] in straightforward practices that reflect ethics and disclosure." In a series of brochures touting the benefits of TICs, a CapWest registered representative in Seminole, Florida stated, among other things, "The SEC advocates full disclosure, and the sponsors . . . must follow many rules to be in compliance . . . ."[32] One of these brochures stated that a TIC investor receives protection from the "extensive" due diligence on such investments conducted by "the securities industry" which, the Firm asserted, "perform[s] thorough analysis to determine if the ownership structure is viable and whether the property is physically sound, economically profitable, has a likelihood of increasing in value, and can generate sufficient income to repay the debt obligation."[33] One page on the website of a real-estate company owned by this registered representative stated, "The real goal [of] all of this [oversight and regulation] is to make the sales and offerings and their regulations [sic] as secure as possible for investors, and bring clarity to any vague issues."[34]

CapWest disputes FINRA's finding that these six communications violated Rule 2210(d)(1)(B). The Firm argues that none of the communications contains the suggestion that a regulatory authority "approved" TIC investments, and further claims, without authority, that "a typical offering memorandum read by the investor will disclaim any such approval." The Firm argues that the statements found to be violative "in no way imply an increased likelihood of a successful investment." According to the Firm, "They simply make the observation that the securities industry is well regulated." The Firm correctly notes that regulatory oversight, in general, provides "investor protection," but this does not permit the Firm, as FINRA found, to make exaggerated claims regarding the "degree of oversight and safety afforded to" TIC investors as a result of such oversight.[35] For example, the statements that TICs are subject to

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offering's contingent and speculative nature, including the possibility of an adverse tax ruling, the lack of liquidity in the securities, and the potential fluctuations of real estate values").

[32] CX-5-CX-8.

[33] CX-8.

[34] CX-76.

[35] *Cf. Pac. On-Line*, 2003 SEC LEXIS 2164, at *14 (finding that "[i]mplying NASD endorsement" of a seminar, by stating that the principal leading the seminar had passed an

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"thorough analysis" by "the securities industry" regarding, among other things, "whether the property is . . . economically profitable, has a likelihood of increasing in value, and can generate sufficient income to repay the debt obligation"[36] exaggerate the level of protection that industry and regulatory oversight provide to TIC investors, as well as the likelihood of a successful investment.

FINRA also found, and we agree, that CapWest violated Rule 2210(d)(1)(B) in three communications that included misleading and exaggerated statements indicating that 1031 Exchanges permit the investor to avoid taxes altogether when they merely allow taxes to be deferred. For example, a two-page brochure used by a CapWest registered representative in Sherwood, Oregon stated that a 1031 Exchange allows an investor to sell a property and purchase another "without a tax consequence."[37] The Sherwood registered representative also used a presentation that claimed, "By taking advantage of a § 1031 exchange, you may conserve equity by not paying tax on realized gain."[38]

NASD Rule 2210(d)(1)(B) prohibits member firms from making "any false, exaggerated, unwarranted, or misleading statement or claim in any communication with the public." CapWest does not address on appeal FINRA's findings of violation of Rule 2210(d)(1)(B) with respect to these three communications. Even if certain of these statements (such as the statement that a 1031 Exchange may be executed "without a tax consequence") may be literally true with respect to the initial transaction, the failure of the advertisement to explain the ultimate tax effect of a 1031 Exchange gave the misleading impression that taxes could be avoided altogether. The Firm's misleading and exaggerated statements regarding the regulatory protections afforded to TIC investments and its misleading and exaggerated statements regarding the tax consequences of TIC investments were material because there is a substantial likelihood that a reasonable investor would have considered the information important in the context of the communication.[39]

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NASD Series 24 exam, violated NASD rules); NASD Rule 2210 Interpretive Material ("IM") 2210-4 (stating, in connection with limitations on member firms' use of FINRA's name in public communications, that the member must "neither state nor imply that . . . NASD or any other regulatory organization endorses, indemnifies or guarantees the member's business practices, selling methods, the class or type of securities offered, or any specific security").

[36] CX-8, CX-68, and CX-165.

[37] CX-9.

[38] CX-164.

[39] *Cf. Basic, Inc. v. Levinson*, 485 U.S. 224, 240 (1988) (stating that "materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information," which is a fact-specific determination).

C. CapWest violated NASD Rules 2210(d)(1)(D) and 2110 because it used communications including improper performance predictions, performance claims, and forecasts.

We sustain FINRA's findings that thirteen of CapWest's communications violated NASD Rule 2210(d)(1)(D)'s prohibition on performance predictions and unwarranted forecasts. The communications included statements predicting that investors would realize positive returns on their investments, often citing specific percentage returns without including any explanation of the historical basis for these claims or any proviso that past results are no guarantee of future performance. One CapWest registered representative used several handouts which described TICs as having a "long term income stream," producing "effortless cash flow," and, on her real-estate website, stated that "TICs are popular because . . . the returns are generally projected and estimated. No management, no fuss, no tenant problems—simply a return on the investment—this is appealing to more and more people."[40] Other CapWest communications included specific percentage return projections. In a script for radio interviews,[41] a CapWest registered representative acknowledged that "each TIC deal will vary," but then stated that a "typical apartment deal today starts with a cash-on-cash return of about 6% to 6.9%;" "typical office and retail deals vary from 6.5% to 7.5%;" and "some of the other asset classes may pay higher, maybe 7.5% to 8%." An advertisement approved for use on Google stated that TICs could provide "potential monthly cash flow over 8%," while another advertisement, approved the same day for use on Yahoo stated, "TIC properties can potentially [provide] cash flow over 10%,"[42] without any explanation for the different figures in the two advertisements. None of these communications cited a basis for these projections.

CapWest defends the performance projections it used as "not promissory" and further states that they "appear to be true," citing only a book written by one of its registered representatives.[43] But the descriptions of the returns as "typical" and statements that TIC

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[40] CX-5, 6, 76, 158.

[41] CX-64. This document, entitled "Radio Interview Questions," is a seven-page suggested set of questions and answers for radio interviews related to a book about 1031 Exchanges and TICs written by the registered representative. The introduction to the document states, "The following questions are suggestions of those that may be asked in an interview – the structure and choice is up to the host."

[42] CX-75.

[43] Attached to its brief on appeal, CapWest included two exhibits. Exhibit A is an 87-page (not inclusive of introductory summary and exhibits) private placement memorandum, dated January 9, 2007, offering TIC securities in an entity called Cabot Turfway Ridge Acquisition, LLC, which was the owner of a 14.57-acre office park, including two office buildings, in Kentucky. Exhibit B is a full copy of a 2007 book "Effortless Cash Flow," authored by Kathy Heshelow.

Rule of Practice 452, 17 C.F.R. § 201.452, permits the submission of additional evidence based on a motion "show[ing] with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously." We exclude

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investments produce "simply a return on the investment" do not refer to past performance. None of the thirteen communications found to have violated this provision includes any disclosure or cautionary language that the results being cited do not guarantee future performance.

Without the requisite qualifying language and the historical basis for such claims and figures, the overall effect of these projections was to imply that an investor in TICs could expect the returns predicted in the communications.[44] As we have previously held, "the blanket nature of the statements made in the advertisements, appearing as they did with neither detail nor qualification, renders them violative of NASD Rules."[45]

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these two exhibits because CapWest did not file a motion to introduce the exhibits, and it neither explains why it did not adduce them previously, as both exhibits were available prior to the commencement of FINRA's disciplinary proceeding, nor shows their materiality. *See, e.g.*, *Joseph S. Amundsen*, Exchange Act Release No. 69406, 2013 SEC LEXIS 1148, at *46 n.83 (Apr. 18, 2013) (declining to admit evidence attached to applicant's brief where applicant failed to file a motion to adduce the evidence and where the evidence applicant sought to adduce was irrelevant to the matters at issue) (citing *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at *58-60 (Nov. 9, 2012)). CapWest contends that anyone who ultimately invested in a TIC would receive a PPM including risk and other disclosures similar to those in Exhibit A. As discussed above, however, Rule 2210 does not permit a member firm to rely on disclosures in other documents to fulfill its obligation to provide investors with a fair and balanced presentation. According to CapWest, Exhibit B (the "Effortless Cash Flow" book) establishes the "typical" rate of return for TICs during the period preceding the Firm's use of the communications at issue. Thus, according to the Firm, the advertisements projecting rates of return for TICs were based on historically accurate data, since the figures cited by the book roughly match those used in the violative communications. We first note that the book contains no support for the rates of return cited therein. Further, as discussed, it is not the historical rate of returns for TIC investments that is at issue here, but rather the Firm's failure to include information in the communications explaining the basis for the claims and noting that past performance is not necessarily predictive of future results.

[44] *Daniel C. Montano*, Exchange Act Release No. 40243, 53 SEC 681, 1998 SEC LEXIS 2874, at *14 (July 22, 1998) (finding that registered representative's predictions in television advertisements of specific results and returns on investment implied to investors that they could expect to achieve such results, notwithstanding the representative's use of couching statements such as "you stand a chance" and "I think").

[45] *Sheen Fin. Resources, Inc.*, Exchange Act Release No. 35477, 52 SEC 185, 1995 SEC LEXIS 613, at *12 (Mar. 13, 1995) (finding claims that investors in the products being touted could achieve specific returns and specific tax advantages by using the strategies discussed in the violative advertisements "imply that any investor may expect such results").

D. CapWest violated NASD Rules 2210(d)(2)(A)(i) and (ii) and 2110 by using a communication that included a customer testimonial without the requisite disclosures.

We sustain FINRA's finding that one CapWest communication violated NASD Rule 2210(d)(2)(A)(i) and (ii)'s requirement to include certain disclosures when using customer testimonials in public communications. The communication was in the form of a promotional postcard from a registered representative in Yorba Linda, California, that included three customer testimonials speaking to the representative's "character," "integrity," and his "keen interest in the financial welfare of his clients."[46] A third testimonial in the postcard stated, "every way you measure [him], on a scale of 1 to 10, he gets a 10!" The postcard did not include the disclosures required under Rule 2210: "that the testimonial may not be representative of the experience of other clients" and "that the testimonial is no guarantee of future performance or success."

In response to FINRA's finding, the Firm argues only that "it must be remembered that all of the 166 allegedly violative communications . . . do not relate to particular products or services." CapWest cites no authority to support its apparent position that these requirements apply only to testimonials in advertisements related to specific products or services, and there is nothing in Rule 2210 that would suggest that its scope is so limited. Rule 2210 applies equally to all member firm communications with the public.

E. CapWest's argument that the communications relating to TICs should be viewed in conjunction with the disclosures made in TIC offering documents is without merit because, under NASD Rules, advertisements must "stand on their own."

CapWest's primary argument in opposition to FINRA's findings of Rule 2210 violations is that its communications should not be viewed in isolation, but rather in conjunction with the disclosures provided in the private placement memoranda ("PPMs") that the Firm claims would always be provided to investors in connection with a TIC offering.[47] CapWest complains that

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[46] CX-62.

[47] CapWest contends that the communications should be viewed "in the context of the total mix of information available to the prospective investor," the materiality standard articulated by the Supreme Court in *Basic*, 485 U.S. at 231-32, and *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448-49 (1976). This misapprehends Rule 2210's focus. NASD Rule 2210 focuses not on all information that is available to a potential investor, but on the content of the communication itself, requiring that the communication on its own be "fair and balanced" and "provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service." It is in this context that the NASD Rule introduces the concept of materiality: "No member may omit any material fact or qualification if the omission, in light of the context of the material presented, would cause the communications to be misleading." *See supra* note 17. As a result, we determine materiality here by looking to whether a fact is substantially likely to be considered important by a reasonable person reading the communication. Further, in its argument that "by the end of the disclosure process CapWest provided investors with all the

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"the NAC abandons rationality and common sense, because it isolates each communication from the context in which it is made." But, in determining whether an advertisement violated NASD Rule 2210, we look to the content of the advertisement alone, and not to other documents associated with the offering. As we have stated, "Advertisements must stand on their own when judged against the standards of [Rule 2210]."[48] Providing customers with PPMs for certain of the TICs that CapWest sold would not cure the Firm's failure to provide a balanced presentation in the communications.[49] Communications must include a balanced discussion of the risks of an investment and may not depend "on scattered information available to the customer" (including in PPMs and other offering documents) for the requisite disclosure of such risks.[50] We therefore reject CapWest's general argument that its communications did not violate Rule 2210 since the PPMs would include risk and other disclosures that were not included in the communications themselves.[51]

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[risk] factors" associated with a TIC investment, CapWest essentially acknowledges that the communications at issue omitted material information regarding the workings, features, and risk factors associated with the investments.

[48] *Sheen*, 1995 SEC LEXIS 613, at *12 (holding that "defects in the advertisements" cannot be cured through detailed explanations elsewhere of the risks of the investments being promoted).

[49] *Excel*, 1997 SEC LEXIS 2292, at *19 (finding that member firm communications, including those aimed at accredited investors, must "contain a balanced statement of the benefits of the investment and its risks").

[50] *Spartis*, 2011 SEC LEXIS 1693, at *39 n.43 (citing *Pac. On-Line*, 2003 SEC LEXIS 2164, at *15 ("disclaimers of the risks of online trading provided to customers at . . . seminars and when . . . customers opened new accounts" failed to cure firm's misleading advertisement because "[a]dvertisements must stand on their own" under NASD's public communications rule); *Donner Corp. Int'l*, Exchange Act Release No. 55313, 2007 WL 516282, at *10 (Feb. 20, 2007) ("The research reports themselves needed to convey a complete and accurate picture and could not depend on information available to investors."); and other cases).

[51] In addition to the arguments discussed above, CapWest contests the qualifications of FINRA's sole hearing witness, investigator Levine. CapWest contends that Levine "is not a lawyer, not an accountant, not a real estate licensee, not securities licensed and had never testified before" and "has never owned an interest in commercial real estate." On these bases, CapWest claims that Levine "was not qualified to provide any expert opinion." Because CapWest claims that the NAC "relied solely upon" Levine's testimony, it argues that "the decision is not supported by any substantial evidence in the record."

We find that FINRA did not, as CapWest suggests, rely solely on Levine's testimony to reach its conclusion that CapWest had violated NASD Rules. Instead, FINRA reviewed each of the communications and made its own findings of violation based on that review. Further, as noted above, the Firm did not call a witness of its own, as it was permitted to do, to rebut Levine's testimony. In addition, Levine testified not, as CapWest contends, "about the intricacies of TICs or 1031 exchanges," but rather about whether the 166 communications complied with NASD advertising rules, with which Levine was extensively familiar. We previously have

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F. CapWest violated NASD Rules 3010 and 2110 because it failed to implement its supervisory system effectively.

NASD Conduct Rule 3010 requires member firms to "establish and maintain" a supervisory system "reasonably designed to achieve" regulatory compliance. FINRA found that, although CapWest had "adequate" procedures in place during the Sweep Period, which required that all public communications be reviewed and approved by Firm supervisory personnel prior to being used by the Firm, the Firm violated Rule 3010 by failing to implement these procedures effectively, in that the supervisory personnel did not have an adequate understanding of the Firm's obligations under Rule 2210.

On appeal, CapWest does not directly address the supervisory violations FINRA found, but states merely that "if the communications . . . are not violative, supervision is not relevant." As discussed above, we find that the record amply supports FINRA's findings of Rule 2210 violations. In his testimony, CapWest's CEO acknowledged that, at the time of the sweep, he was not fully aware of "what the rules were" with respect to the Firm's compliance with NASD advertising requirements. His acknowledgment supports FINRA's finding that the supervisory system had not been implemented effectively at the time the Firm used the violative communications. Further, we agree with FINRA that the approval of all 166 violative communications by CapWest principals shows that those principals did not understand the content standards under Rule 2210 and thus could not effectively execute their supervisory duties.[52] Although the Firm had adequate supervisory procedures in place, it did not effectively implement them, which allowed the Firm to disseminate 166 violative public communications during a six-month period. The changes to the Firm's policies after the sweep, which were discussed by the Firm's CEO during his testimony, although commendable, do not excuse the violations.[53] Thus, we affirm FINRA's finding that CapWest violated NASD Rule 3010 by failing to implement its supervisory procedures effectively.

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considered similar testimony in finding violations of SRO rules. *See, e.g., John R. D'Alessio*, Exchange Act Release No. 47627, 56 SEC 396, 2003 SEC LEXIS 806, at *37 (Apr. 3, 2003) (citing, in support of findings, hearing testimony of NYSE staff member that NYSE's regulatory position that sharing in profits and losses created an interest in an account). *Cf. Calais Res., Inc.*, Exchange Act Release No. 67312, 2012 SEC LEXIS 2023, at *8 (June 29, 2012) (citing Declaration of Commission staff member identifying material deficiencies in Commission filings in support of findings of violations). In any event, we have reviewed FINRA's findings *de novo* and agree, as discussed, that the communications violated the NASD Rules as alleged.

[52] *See Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *35 (June 29, 2007) (finding that NASD supervisory rules require members to ensure that supervisors understand and can effectively conduct their duties); *see also* NASD Rule 3010(a)(6) (requiring member firms to make "[r]easonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities").

[53] *Cf. John B. Busacca III*, Exchange Act Release No. 63312, 2010 SEC LEXIS 3787, at *43 (Nov. 12, 2010) ("Reasonable supervision . . . required Busacca . . . to address known deficiencies promptly . . . not only after regulatory action had commenced."); *Kresge*, 2007 SEC
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IV.

Under Exchange Act Section 19(e)(2), we sustain FINRA sanctions unless we find that, giving due regard to the public interest and the protection of investors, the sanctions are excessive, oppressive, or impose an unnecessary or inappropriate burden on competition.[54] CapWest takes the position that it committed no violations and thus no sanction is warranted.

A. The $25,000 fine FINRA imposed for CapWest's Rule 2210 violations is not excessive or oppressive.

In assessing the appropriate sanction to impose on CapWest, FINRA looked to its Sanction Guidelines, which it promulgated to achieve greater consistency, uniformity, and fairness in its sanctions.[55] Although the Guidelines do not bind us, they serve as a benchmark for our review under Exchange Act Section 19(e)(2).[56] The Guidelines provide "Principal Considerations in Determining Sanctions," which apply to sanctions for any violation of FINRA Rules.[57] The Principal Considerations applicable to all violations identify several factors to be weighed, including: whether the respondent engaged in numerous acts or a pattern of misconduct; whether the respondent voluntarily employed subsequent corrective measures, prior to detection or intervention by a regulator, to revise general or specific procedures to avoid recurrence of misconduct; whether the respondent's misconduct was the result of an intentional act, recklessness, or negligence; and the level of sophistication of the injured or affected customer.[58] The Principal Considerations specifically applicable to Rule 2210 violations require adjudicators to weigh whether the violative communications were circulated widely.[59]

As discussed above, many of the advertisements and sales literature at issue here were widely circulated, in magazines and other publications that were available to the general public or on websites that were unrestricted. The NAC correctly found the wide circulation of many of

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LEXIS 1407, at *37 ("Kresge's [remedial] actions occurred months after the misconduct at issue already had transpired and after [FINRA] began its investigation.").

[54] 15 U.S.C. § 78s(e)(2). CapWest does not claim, nor does the record show, that FINRA's action imposed an unnecessary or inappropriate burden on competition.

[55] *Richard A. Neaton*, Exchange Act Release No. 65598, 2011 SEC LEXIS 3719, at *39 n. 38 (Oct. 20, 2011).

[56] *Jason A. Craig*, Exchange Act Release No. 59137, 2008 SEC LEXIS 2844, at *18 n.27 (Dec. 22, 2008).

[57] *Guidelines*, at 6-7.

[58] In addition, under the General Principles Applicable to All Sanction Determinations, adjudicators are instructed that they "must always exercise judgment and discretion and consider appropriate aggravating and mitigating factors in determining remedial sanctions in each case." *Guidelines*, at 3.

[59] *Id.* at 79.

the communications to be an aggravating factor in its sanction determination.[60] The NAC also noted as aggravating that the Firm's misconduct would not have stopped absent FINRA's sweep and its subsequent enforcement action against the Firm.[61] Further, because CapWest did not make changes to its supervisory system until after FINRA detected and intervened to stop the violations, the improvements the Firm made to its supervisory system are not mitigating in assessing the appropriate sanction for the Firm's violations.[62]

The Principal Considerations for Rule 2210 violations also recommend differing sanctions depending on whether the adjudicator finds that the violations were "inadvertent," as opposed to finding them to have been "intentional or reckless." We agree with FINRA that CapWest's use of thirteen separate communications that included improper performance projections was egregious. Without providing the historical basis for such statements and without warning potential investors that past results do not guarantee future performance, the Firm misled the potential investors who received these communications by suggesting that they too could expect such returns. We also agree with FINRA that the Firm's use of six communications that touted the investor protections that regulatory oversight provides for TIC investments was misleading and egregious. By giving the impression that investors could rely on such protections to add "security" to their investments, the Firm made a highly misleading presentation. We find that the violations concerning these nineteen communications were at least reckless. For "intentional or reckless" violations, the Guidelines recommend a fine of at least $10,000 per violation, and as much as $100,000 per violation.[63] For these egregious violations alone, FINRA could have imposed a $190,000 fine, at the minimum sanction level of $10,000 per violation authorized by the Guidelines.

In addition to the egregious violations, FINRA found that CapWest committed at least 157 "inadvertent" violations of Rule 2210(d)(1)(A) and one "inadvertent" violation of Rule 2210(d)(2)(a)(i) and (ii). We agree that these 158 violations were committed inadvertently. Under the Guidelines, FINRA could have imposed a minimum fine of $1,000 each for these violations for a total fine of $158,000.[64]

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60 It is an aggravating factor when the communications at issue are "freely available on [the member firm's] website and access to them [is] not restricted in any manner." *Donner*, 2007 WL 516282, at *13 n.64.

61 *Guidelines*, at 6 (consideration 3: "whether [a] . . . member firm respondent voluntarily employed subsequent corrective measures, prior to detection or intervention . . . by a regulator, to revise general and/or specific procedures to avoid recurrence of misconduct").

62 *Cf. Saad v. SEC*, 718 F.3d 904, 913-14 (D.C. Cir. 2013) (remanding proceeding where Commission did not fully address, in its sanctions analysis, the mitigative impact of the termination of applicant's employment before detection of the underlying misconduct by FINRA).

63 *Guidelines*, at 80.

64 *Id.* at 79.

We have previously held that an NYSE Rule, analogous to Rule 2210, "serves an important policy objective by encouraging NYSE members and their associated persons to provide full and fair disclosure to their investors."[65] CapWest thwarted this policy goal through its use of 166 violative communications. The NAC exercised its discretionary authority, resulting in a significant reduction of the $150,000 fine the Hearing Panel imposed, even though the NAC concurred with the Hearing Panel's findings of violation.[66] FINRA's fine of $25,000 for *all* of the Firm's violations is not excessive or oppressive.

B. The $25,000 fine FINRA imposed for the Firm's violations of Rule 3010 is neither excessive nor oppressive.

FINRA's Sanction Guidelines set out sanctions recommendations for violations of Rule 3010 for failure to supervise. The Guidelines recommend a fine of $5,000 to $50,000. The Guidelines recognize the following principal considerations in determining sanctions for a failure to supervise: (1) whether the respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny and whether individuals responsible for underlying misconduct attempted to conceal misconduct from the respondent; (2) the nature, extent, size, and character of the underlying misconduct; and (3) the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls. Although there is no evidence of any red flags or attempts to conceal the misconduct here, CapWest's CEO acknowledged that he did not realize "what the rules were" regarding the Firm's communications with the public, which indicates that the Firm had failed to address its supervisory responsibilities regarding regulatory compliance in an appropriate manner. Given the large number of violative communications over a relatively short six-month period and the apparent failure of Firm supervisors to recognize these violations, a fine of $25,000, in the middle of the recommended range, is neither excessive nor oppressive.

Under these circumstances, we conclude that FINRA's sanctions are justified under its Sanction Guidelines, result from a thoughtful weighing of the relevant facts, and are appropriately remedial because they will serve as a reminder that member firms must comply with the advertising rules and deter others from engaging in similar misconduct.[67]

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65 *Spartis*, 2011 SEC LEXIS 1693, at *47-48.

66 Citing the *Guidelines*' statement that adjudicators, in assessing sanctions, should consider "the level of sophistication of the . . . affected customer," the NAC noted, as mitigating, that "the target audience . . . generally comprised accredited investors that already owned income-producing real estate and the . . . financial professionals who advise them." While such circumstances are not relevant to the determination of liability, they can be considered in assessing sanctions, as was done here.

67 *See McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005) ("[G]eneral deterrence . . . may be considered as part of the overall remedial inquiry.").

We find that the sanctions imposed against CapWest are neither excessive nor oppressive and are appropriate remedial sanctions for the violations, and we sustain FINRA's findings of violations.

An appropriate order will issue.[68]

By the Commission (Chair WHITE and Commissioners AGUILAR, GALLAGHER, STEIN and PIWOWAR).

Elizabeth M. Murphy
Secretary

[68] We have considered all the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71340 / January 17, 2014

Admin. Proc. File No. 3-15259 (CORRECTED)

In the Matter of the Application of

CAPWEST SECURITIES, INC.
c/o H. Thomas Fehn, Esq.
Fields, Fehn & Sherwin
11755 Wilshire Blvd., 15th Floor
Los Angeles, CA 90025

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

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

ORDERED that the disciplinary action, and the sanctions imposed, by FINRA on CapWest Securities, Inc. be, and they hereby are, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary