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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

In re the Application of

Frederick Shultz and Blair Mielke

For review of action taken by FINRA

Admin. Proc. File No. 3-16022

BRIEF OF RESPONDENTS FREDERICK SHULTZ AND BLAIR MIELKE

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INTRODUCTION

Respondents Blair C. Mielke and Frederick Shultz were registered representatives of Brookstone Securities, Inc. ("Brookstone"). This case essentially involves allegations that they were guilty of "selling away" – selling securities without informing or obtaining approval from Brookstone. Mielke and Shultz were involved in selling interests in Midwest Investment Partners, LLC ("Midwest") pursuant to a private placement. Mielke and Shultz maintain Brookstone was aware of the sales of Midwest at issue. Brookstone denies they were aware Midwest was selling membership interests prior to the execution of the selling agreement between Midwest and Brookstone. The securities sales at issue took place between January 2008 and October 2009.

PROCEDURAL HISTORY

FINRA filed an eight (8) count cause of action against Mielke, Shultz and two other registered representatives in April 2011.[1] The causes of actions were as follows: (1) Shultz and Mielke engaged in undisclosed business activities in violation of FINRA rules 3030, 2110, and 2010; (2) Shultz and Mielke engaged in undisclosed private securities transactions in violation of FINRA rules 3040, 2110, and 2010; (3) Shultz's participation in private securities transactions caused Brookstone to maintain inaccurate books and

[1] Only Mielke and Shultz are involved in this appeal.
[2] The NAC actually imposed no sanction in light of the bar imposed on Shultz.

records in violation of NASD Rule 3110 and FINRA Rule 2010; (4) Mielke and Shultz made incorrect statements on Brookstone compliance questionnaires in violation of NASD Rule 2110 and FINRA Rule 2010; (5) Shultz misused customer funds in violation of FINRA Rules 2150 and 2010; (6) Mielke failed to respond completely and timely to FINRA's requests for information in violation of FINRA rules 8210 and 2010; and (7) Shultz failed to appear timely for on the record testimony in violation of FINRA Rules 8210 and 2010. The eighth cause of action was not against Mielke or Shultz.

FINRA conducted a four day hearing in March 2012 and issued a decision in September 2012. Shultz and Mielke requested a review of that decision by the National Adjudicatory Council. The NAC issued its decision on July 18, 2014. Shultz and Mielke now seek review by the SEC.

FACTS

I. The Respondents

Blair Mielke was first registered in the securities in industry in 1988. R. 2491 (CX-4). He held a Series 6, Series 63, and Series 65 licenses. *Id.* He was affiliated with Brookstone Securities, Inc. ("Brookstone") from June 2007 until November 2009. *Id.*

Shultz began his career in the securities industry in 2006 after retiring from his previous career as a mathematician, computer scientist, and computer engineer. R. 2064-2065. Shultz held Series 6, Series 63, and Series

65 licenses. R. 3251 (CX-45). He was affiliated with Brookstone from June 2007 until November 2009. Id.

II. Midwest Investment Partners, LLC

Midwest Investment Partners, LLC ("Midwest") was formed as a limited liability company with the State of Indiana on January 24, 2008. R. 2345 *(CX-1), R. 2545 (CX-11).* Midwest filed Form Ds (Notice of Exempt Offering of Securities) with the SEC showing the interests were being sold pursuant to an exemption from registration. R. 6318 (RX 107); R. 2077. Harvest Midwest Group, LLC ("Harvest") was the entity formed to act as the managing entity of Midwest and owned all the voting interests of Midwest. R. 1895. Shultz was the managing member of Harvest. R. 2109. Mielke owned 75% of the entity that owned Midwest.

Respondent Mielke hired attorney Steve Goodman of the firm Lynch, Cox, Gilman & Goodman of Louisville, Kentucky to draft the private placement, subscription agreement, and offering documents for Midwest. R. 1767, R. 1906. Goodman was also retained to insure compliance with FINRA rules and to negotiate a selling agreement with Brookstone. R. 1767. Mielke repeatedly sought and received assurance from Goodman throughout the process that Midwest was in compliance with the law. R. 1926.

III. Disclosure of Midwest to Brookstone.

Mielke met with the Anthony Tuberville, Chairman of the Board of Brookstone, prior to the formation of Midwest and discussed his intention to

leave the securities industry and form an investment fund. R. 1908, 1910, 1912. Tuberville persuaded Mielke to remain with Brookstone. R. 1913. Mielke testified that Tuberville approved the sale of the Midwest offering in 2008 but wanted to refrain from discussions about having Brookstone sell Midwest until Mielke's suspension ended. R. 1914.

Mielke testified that he later saw email exchanges between Goodman and Brookstone regarding the offering. R. 1913. In addition, Brookstone employees conducted due diligence on Midwest. R. 1306, 2196.

In December 2008, Mielke, Shultz, Goodman, Thomas Gorter, and Anthony Tuberville, met in Orlando, Florida to discuss a selling agreement with Brookstone for the sale of Midwest interests. R. 1199, 1202-1203, 1918-1919. Mr. Mielke was relying on Mr. Goodman to work with Brookstone's compliance department to sell the product through Brookstone. R. 1919. Thomas Gorter testified that Mr. Tubervill asked him at this meeting to start speaking with Brookstone representatives about selling Midwest interests. R. 1735. Tuberville said Brookstone would need to review and approve the offering materials for Midwest before Brookstone would sell Midwest. R. 1204.

After this meeting, Goodman sent Brookstone Midwest offering documents for review. R. 1919. David Locy, President of Brookstone, was asked by Mr. Tuberville to review the Midwest offering soon after the Orlando meeting. R. 1262. Mr. Locy rejected the first private placement

memorandum he received from Midwest. R. 1265. Midwest then retained a second law firm out of Louisville, Kentucky, Stoll Keenon & Ogden, PLLC, to revise the offering materials. R. 1919. He testified he received a second draft of the offering documents in June 2009. R. 1268. He approved the Midwest offering on behalf of Brookstone in June 2009. *Id.* A selling agreement between Brookstone and Midwest was executed shortly thereafter. *Id.*

Mr. Mielke testified he believed the agreement with Brookstone was that sales by Brookstone representatives, other than Shultz, Meilke, and Thomas Gorter, would be processed through Brookstone. R. 2053. However, if the sales were by Shultz, Mielke, or Gorter, those sales would not be processed through Brookstone. *Id.* Mielke testified he heard Mr. Locy verbally approve sales of Midwest interests prior to the approval of the private placement memorandum. R. 1913-1914.

Mr. Shultz testified that Mr. Goodman stated that Brookstone knew Mielke and Shultz were operating Midwest. R. 2077. He also testified that Midwest was in frequent communication with their counsel about legal compliance. R. 2078.

During December 2008, a Brookstone compliance officer, Brian Sweeny, conducted an audit of the Brookstone Evansville office (the office used by Mielke and Shultz). RX-118. The report of that audit contains a note from Sweeny stating: "Look into Vestium." RX-118. *Id.* Vestium was the

entity into which Midwest was investing. No evidence was presented as to why this note was made or what Brookstone did with the information.

The proposed offering materials received by Brookstone prior to the approval clearly indicate Midwest was already involved in selling interests to investors. The first version of the Private Placement Memorandum received by Locy states that Midwest "currently markets and sells its investments through licensed agents throughout the United States." R. 1907, 6601 (RX-115).

Brookstone denies that it approves any sales of Midwest prior to the selling agreement and denies that it was aware interests in Midwest were being sold prior to the execution of the selling agreement. R. 202, 203, 1294, 1295. After being contacted by FINRA about Midwest, Brookstone terminated Shultz and Mielke. R. 1295.

ARGUMENT

I. Private Securities Transactions.

NASD Rule 3040 prohibits an associated person from engaging in a private securities transaction without prior notification to the member firm. If the person is receiving selling compensation, the person must give prior written notice to and receive written approval from the firm before engaging in transactions. NASD Rule 3040.

Mielke and Shultz did provide notice of their activities with Midwest through the outside business interest disclosures which they provided to

Brookstone and the ongoing communication between Midwest and Brookstone regarding Midwest. R. 3257 (CX-46), R. 6835 (CX-137), R. 6837 (CX-138), R. 6839 (CX-139), R. 6845 (CX-142). There is no evidence Brookstone ever asked any questions of Mielke or Shultz about these disclosures or ever indicated they were insufficient. These disclosures may not have been "perfect", but they were far attempting to conceal any transaction, especially when the disclosures are considered in context of the ongoing exchange of information with Brookstone.

II. Failure to Disclose Outside Business Activities.

As seen above, Brookstone was receiving frequent communication regarding Midwest. It is hard to imagine how Brookstone could claim they were not aware of the Shultz and Mielke's activities. In addition, the compliance documents signed by Shultz and Mielke also disclosed their involvement with Midwest. R. 3257, 6835, 6837, 6839, 6845.

Brookstone was in frequent communication with either the respondents or their counsel about Midwest. In addition, it received disclosures from the respondents confirming their participation with Midwest. Brookstone was well aware of the respondent's activities with Midwest.

II. Causing Inaccurate Entries in Brookstone's Books and Records.

FINRA alleges that the Respondents are guilty of causing inaccurate entries in Brookstone's books and records because Shultz and Mielke did not cause the sales of Midwest interests to be processed through Brookstone after the execution of the selling agreement between Midwest and Brookstone. However, there was nothing in the selling agreement that required Midwest to process the transactions through Brookstone. The counsel employed by Midwest never instructed Mr. Shultz to process the transactions through Midwest. R. 2080. There is no reason to believe Mr. Shultz's actions, even if those actions violated any rule, were an effort to hide any transaction.

III. Failure to Cooperate in FINRA investigation.

Mielke was sanctioned for failing to provide requested documents to FINRA. Shultz was sanctioned for failing to appear for an on the record interview.

Redacted

R. 1974. Obviously, his health problems made it very difficult to fully participate in the investigatory process. His actions must be evaluated in light of these health issues.

Shultz had significant family issues that made it difficult for him to participate in the FINRA process. Redacted

Redacted

. These problems obviously made it difficult for him to travel. It should also be noted that Mr. Shultz did eventually appear for his on the record interview.

Also, it should be noted Shultz appeared for his on the record interview on January 14, 2010, the same day Mielke had his on the record interview. R. 2097. Mr. Shultz was unable to complete his on the record interview after his attorney withdrew from representing him after the conclusion of Mielke's testimony. Id. Understandably, Mr. Shultz wanted to be represented at his testimony.

Both Shultz and Mielke had serious issues to deal with during the period of the FINRA investigation. There has been no showing that FINRA's ability to investigate this matter was affected in any way. Thus, FINRA was able to fully to present this case for adjudication. The health and family issues that affected Mielke and Shultz must be considered when evaluating their cooperation.

IV. Shultz's Misuse of Customer Funds.

Shultz acknowledged that he made and accounting error. R. 2146. There is no evidence these errors were anything other than honest mistakes or that Shultz had any improper motive. After Midwest's accountant discovered the error, it was corrected. R. 2146-2147. There was no intent to defraud any investor, and the error was corrected.

V. Sanctions

The record in this case makes clear that the respondents never sought to defraud our deceive. At worst, there were failures of communication and honest mistakes.

A. Sanction for Private Securities Transactions and Outsisde Business Activities.

These two violations involve the same alleged conduct; thus, a unitary sanction is appropriate as recognized in the NAC decision. The FINRA Sanction Guidelines ("Guidelines") provide a wide variety of factors in determining the proper sanction. *Guidelines*, at 14-15. Included in these factors are considerations whether the securities sold violated any laws and whether the sale of the securities harmed the investing public.

There has been no finding that the sale of Midwest interests violated any law or that the investors were harmed. Protection of the public should be the primary consideration in imposing sanctions. In this case, even though the investors were not harmed, Mielke and Shultz have been given the most severe sanction possible. *See Guidelines,* pp. 13-15 (providing the list of recommended sanctions for private securities transactions and outside business activities.) Mielke and Shultz should not have been given the most

severe sanction possible when the most important consideration, protection of the public, leads to a lesser sanction.

B. Inaccurate Books and Records

Only Shultz was sanctioned under this allegation. There is no evidence Shultz had any improper motive. He explained that the counsel Midwest had retained never instructed him to send the documents to Brookstone. R. 2080. Also, the selling agreement between Midwest and Brookstone contained no indication the documents should be sent to Brookstone.

The failure to send the documents to Brookstone was an honest mistake. There was a selling agreement in place and Brookstone and Midwest had been communicating regarding Midwest for a long period of time. Shultz had no reason to "hide" the transactions from Brookstone. With no indication of an improper motive, any sanction for this mistake should be minimal.[2]

C. Compliance Questionnaires.

Any problem with the compliance questionnaires must be considered in light of the ongoing communications between Midwest and Brookstone. Mielke testified he prepared his answer because he believed Brookstone had already approved the sale of the Midwest interests. R. 1923-1924. Mr. Mielke's conversations with his counsel confirmed that Brookstone was aware of the sales. R. 1924. Thus, Mielke had a good faith belief that the statements

[2] The NAC actually imposed no sanction in light of the bar imposed on Shultz.

on his compliance questionnaires were accurate because Brookstone was already aware of the facts. *Guidelines*, p. 37 (providing that respondent's good faith belief is a mitigating factor).

Mr. Shultz followed Mr. Mielke's lead in preparing his answer. R. 2166. As Mr. Mielke had a good faith belief his answers were not improper, it was not improper for Shultz to follow Mielke's example. In the mind of Mr. Mielke and Mr. Shultz, Brookstone had already approved the sales of Midwest. Thus, there was no reason to be believe Brookstone was being misled.

Thus, as the evidence does not support the conclusion that the respondents were attempting to mislead Brookstone, a bar was an overly harsh penalty.

D. Misuse of Customer Funds

The original hearing panel found that Shultz's accounting error was simply a "mistake" and that Shultz did not "intentionally and knowingly exercise[] authority over customer funds." In addition, the mistake was corrected and no investor suffered any harm. Thus, any sanction for the misuse of customer funds should be minimal.[3]

E. Failure to Respond to FINRA Requests

Mielke's problems in responding to FINRA requests were the result of profound health problems. He did willingly appear for an on the record

[3] The NAC did not impose any sanction for Shultz for this issue due to the bar already imposed.

interview and provide a number of records. His failure to cooperate more fully was a result of his illness. His sanction should be evaluated in light of this illness. *Guidelines*, p. 33 (stating that respondent's reason for failure to answer requests should be considered in imposing sanctions).

Shultz's was sanctioned for failure to appear for his on the record interview. He did appear for the original interview time but was unable to complete it for reasons beyond his control. R. 2097. He did subsequently participate in an interview. He was also dealing with significant family issues during this period which made travel very difficult. As with Mr. Mielke, his failure to cooperate must be evaluated in light of this issue.

There is also no evidence that the actions of Mielke or Shultz had any effect on the ability of FINRA to investigate this case or present evidence. *Guidelines*, p. 33 (stating that importance of information requested should be considered in evaluating sanctions). The case was fully presented over a four (4) day hearing to the hearing panel. Mielke and Shultz should not receive a bar from any failure to respond to a request when this failure apparently had no effect on the process, especially when one considers the significant issues affecting them.

CONCLUSION

Any failures on the part of the respondents were not the result of any intent to deceive. No investor was harmed by any of the actions at issue in this case. The Respondents request that the SEC find they committed no

rules violations. If any rules violation is found, the bar previously imposed on both Respondents was overly harsh. The sanctions should be amended.

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