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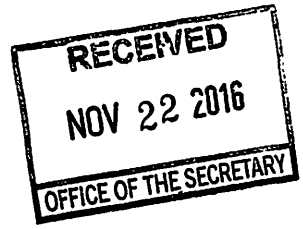


**BEFORE THE**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C.**

In the Matter of the Application of

KCD Financial, Inc.

For Review of

FINRA Disciplinary Action

File No. 3-17512

## FINRA'S BRIEF IN OPPOSITION TO APPLICATION FOR REVIEW

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## I. INTRODUCTION

KCD Financial, Inc. ("KCD") participated in a distribution of unregistered securities that did not qualify for a registration exemption and persisted in selling unregistered securities even after it was warned that a newspaper published an article about the unregistered securities, which was a general solicitation. From late March 2011 until after October 2011, KCD representatives sold at least $2 million of interests in the WRF Distressed Residential Fund 2011, LLC ("the WRF Fund") when no registration statement was in effect. Although the offering was purported to be exempt from registration under Rule 506 of Regulation D, it was not. The issuer violated Rule 506's prohibition on general solicitation or general advertising when it generated a press release about the WRF Fund and posted two favorable newspaper articles that resulted from that press release on its unrestricted website. KCD has also failed to prove, as required by Rule 506, that interests in the fund were sold only to accredited investors and no more than 35 persons who

met certain sophistication criteria. By acting in contravention of Section 5 of the Securities Act, KCD violated FINRA's rule requiring firms to adhere to just and equitable principles of trade.

KCD also failed to take reasonable supervisory steps to prevent the violative sales. Shortly after the newspaper articles were published, the issuer's securities attorney informed KCD about one of the articles and that it was *a breach of the general solicitation prohibition*, and KCD also learned that the issuer had posted the articles on its website. Despite the breach and the resulting loss of the Rule 506 exemption, KCD did not instruct its representatives to halt sales of the WRF Fund. Instead, KCD permitted its representatives to continue selling the WRF Fund.

FINRA's findings that KCD sold unregistered securities in violation of FINRA rules and failed to supervise those sales are supported by the record and consistent with the purposes of the Securities Exchange Act of 1934. KCD, which does not dispute the core facts, points to nothing that shows otherwise. Although KCD argues that the press release and articles were not an "offer" of securities, those communications—which specifically mentioned the WRF Fund and its issuer, contained favorable descriptions of the issuer and the market in which the WRF Fund would operate, and were made when the WRF Fund was under pressure to raise capital—were clearly designed to arouse investor interest and, thus, *were* an offer. KCD also contends that the NAC failed to credit witness testimony that KCD sold interests only to pre-existing customers who had not seen the articles. Such a showing is not material, however, because the relevant inquiry looks to the manner in which the interests were *offered* and whether it involved a general solicitation. Even if it were material, the testimony on which KCD relies was conclusory in nature, provided by witnesses whose reliability was questionable, and fell far short of the explicit and exact evidence needed to demonstrate a registration exemption.

Finally, the $73,000 fine and censure that the NAC imposed on KCD for its serious violations reflected a careful weighing of aggravating and mitigating factors, are consistent with FINRA's Sanction Guidelines ("Guidelines"), and are appropriate to remedy the misconduct and deter KCD and others from engaging in similar violations in the future. The Commission should sustain the NAC's findings and sanctions in their entirety.

## II. FACTUAL BACKGROUND

### A. KCD

KCD, headquartered in Wisconsin, has been a broker-dealer since 2003. RP 851, 2312, 2657; Central Registration Depository (CRD®).[1] One of KCD's branch offices was in Dallas, Texas. RP 2657.

### B. Westmount Realty Finance and the WRF Fund

In 2011, KCD representatives based in Dallas (and other areas) sold interests in the WRF Fund. RP 2164-2165, 2166, 2401, 2445-2446, 2688. The WRF Fund was the first securities offering sponsored by Westmount Realty Finance LLC and sold through KCD. RP 2438, 2766.

Westmount Realty Finance was formed in 2010 by the two principals of Westmount Realty Capital LLC (Cliff Booth and Steve Kanoff) and the principals of Realty Capital Partners LLC. RP 2171, 2765. Westmount Realty Capital and Realty Capital Partners previously sponsored real estate investment programs, the latter having done so through KCD. RP 2379-2382, 2390, 2765-2766. Westmount Realty Finance became one of the "d/b/a" names for KCD's Dallas office. RP 2168, 2172, 2173, 2417, 2658-2659.

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[1] References to the certified record are cited as "RP _____." References to applicant's opening brief and notice of appeal are cited as "Br. ___" and "NOA ___," respectively.

The WRF Fund planned to invest in distressed and foreclosed properties and "flip" them. RP 2165. During the relevant period, banks were selling residential assets to bidders approved by Fannie Mae or Freddie Mac. RP 2394. The WRF Fund was seeking to partner with those approved bidders and purchase "bank owned real estate." RP 2394-2395.

The WRF Fund sought to raise funds through a private offering. The private placement memorandum ("PPM") for the WRF Fund, dated March 15, 2011, indicated that the offering size was $10 million and that the deadline for a minimum, $1 million subscription was July 1, 2011 (unless extended by up to 90 days). RP 2743, 2750. It also stated that the offer and sale of interests relied on a registration exemption under Regulation D. RP 2744, 2747, 2750. That exemption, as a filing later showed, was Rule 506. RP 2165-2167, 2407-2408, 2672. Rule 506 prohibits general solicitation or general advertising, and requires that interests be sold only to accredited investors and no more than 35 persons who meet certain sophistication criteria. 17 C.F.R. §§ 230.506(b) (2011), 230.502(c) (2011), 230.501(e)(1)(iv).

Isaac Gregory ("Gregory")—Westmount Realty Finance's senior vice president of capital markets, a KCD registered representative, and the Dallas branch office manager—testified about Westmount Realty Finance's relationship with KCD, the sales of the WRF Fund, and his role in the fund's offering. RP 2185, 2377, 2378, 2383, 2416, 2658. Westmount Realty Finance had an "issuer side" that "put[ ] together the offerings" and a "FINRA sales side" comprised of KCD registered representatives who only sold Westmount Realty Finance's offerings. RP 2383-2384, 2386, 2658, 2689. Although not a registered principal, Gregory was responsible for "overseeing" the KCD representatives in the Dallas office. RP 2185, 2377-2378, 2416-2417. That office was supervised by KCD's home office and KCD's chief compliance officer, who in March 2011 was Jeff Larson. RP 2416-2417.

On March 15, 2011, Larson, on behalf of KCD, signed an agreement to solicit purchasers of interests in the WRF Fund. RP 2395-2397, 2679-2688. Gregory testified that the agreement meant "we were approved to . . . launch[ ] the project to our base of preexisting investors." RP 2397. Within two to three business days, Gregory sent an e-mail about the offering to, as he described it, "roughly 1,200 high net worth individual accredited investors and registered investment advisors." RP 2383, 2397-2399, 2405.

### C. Westmount Realty Finance's Press Release and the Ensuing Newspaper Articles

As of late April 2011, KCD's representatives had not sold any interests in the WRF Fund. RP 2441-2442, 2672. On April 26, 2011, Westmount Realty Finance issued a press release concerning the WRF Fund that was "picked up" by two news agencies, the *Dallas Business Journal* and the *Dallas Morning News*, which then published articles about the WRF Fund. RP 2168, 2170, 2174, 2175, 2186, 2418, 2661, 2665, 2689. Both articles were generally available on the newspapers' unrestricted websites. RP 2168-2170, 2176. The *Dallas Business Journal* article read as follows:

> **Westmount Realty launches $10M RE fund**
>
> * * *
>
> Dallas-based Westmount Realty Finance LLC announced Tuesday that it launched a $10 million real estate fund to acquire bank-owned residential properties and nonperforming, discounted residential loans.
>
> * * *
>
> The fund, named [WRF Fund], will have a 12-month investment period – and due to the short window for the assets to be purchased and resold, the firm expects to reinvest sales proceeds in additional assets during the period.
>
> The firm has continued seeing a steady stream of buying opportunities, said Stephen Kanoff, chief investment officer.

RP 2665. The *Dallas Morning News* article stated:

> Dallas investor launches residential property investment fund
>
> Dallas-based Westmount Realty Finance LLC said Tuesday that it has set up a special residential investment fund to acquire residential properties and non-performing residential loans from lenders.
>
> * * *
>
> "We continue to see a steady stream of buying opportunities," . . . Westmount's chief investment officer . . . said in a statement. "With nearly 4 million foreclosure filings in 2010, not only is the U.S. experiencing record-level foreclosure activity, but most industry experts aren't anticipating a slowdown for at least the next couple of years."
>
> In just over a year, Westmount has purchased more than 530 distressed residential assets.[2]

RP 2661. On May 5, 2011—nine days after the press release and the resulting articles—KCD made its first sale of WRF Fund interests. RP 2441-2442, 2672.

### D. KCD Learns of the Breach of the General Solicitation Prohibition Yet Does Not Halt Sales

Gregory admitted in a May 3, 2012 letter that, shortly after the articles were published, Westmount Realty Finance's securities attorney informed him of the *Dallas Business Journal* article and that it was a "breach" of the prohibition against general solicitation.[3] RP 2399, 2689. Gregory testified that the attorney recommended that Westmount Realty Finance publish a

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[2] Although the press release is not in the record, the NAC reasonably inferred that the information in the newspaper articles derived from the press release.

[3] In its opening brief, KCD incorrectly asserts that Gregory wrote that the attorney informed him that the newspaper article "may" have been a breach. Br. 8. Gregory did not qualify his description with "may." Gregory wrote, "the securities attorney made us aware of the breach of general solicitation." RP 2689.

rescission of the article and not post it on its website. RP 2402. Gregory did not recall, however, if he asked the attorney whether the KCD representatives should not sell the offering. RP 2437.

After learning of the breach from the attorney, Gregory informed Larson about it. RP 2400-2401, 2422. Gregory and Larson "agreed . . . to continue . . . sell[ing] the offering despite the general solicitation" and "decided . . . to have a conversation" with KCD's registered representatives. RP 2401, 2430-2431. Gregory testified that he informed the KCD representatives about the article and instructed them to ask persons who contacted them about the WRF Fund, but who "did not have a preexisting business relationship" with KCD or Westmount Realty Finance, how they learned about the offering; "if the answer was: I read an article about it in the paper," then "they were to tell that person" that "we cannot let you invest in this offering." RP 2401-2402.

At some point after Gregory gave these instructions to KCD's representatives, Gregory learned that the two articles had been posted on the Westmount Realty Capital website on pages that contained a "Contact Us" link. RP 1524, 2170, 2174, 2195, 2402, 2403, 2661, 2663, 2966. Gregory informed Booth and the Westmount "marketing department" that the articles "should have never happened," that "[y]ou should have consulted me," and that the articles "ha[d] to come down from the website." RP 2449-2450. Booth showed "little concern" and "didn't understand why it was a big deal" before finally saying "okay, I get it." RP 2450. Gregory also asked the "technology department" to remove the articles from the website. RP 2403. There is no evidence that Gregory ever apprised KCD's representatives about the articles on the Westmount website or instructed KCD's representatives to ask potential investors if they had read anything about the WRF Fund offering on the Westmount website. Gregory had the

authority to halt sales, but he did not do so. RP 2426-2427. Gregory testified, "[n]obody . . . ever told me" to halt sales. RP 2428.

### E. KCD Representatives Continue to Sell the WRF Fund While the Newspaper Articles Remained on the Website

In October or November 2011—months after KCD learned about the breach of the general solicitation prohibition—FINRA examiner Eugene Teh found both newspaper articles generally available on the Internet, including the Westmount website, and "not strictly limited to accredited investors or anybody that . . . [Westmount Realty Finance] or KCD might know or have an existing relationship with." RP 2169; *see also* RP 2163, 2167-2168, 2170, 2174, 2176, 2189, 2190, 2661, 2663. At least one person who was interested in investing in the WRF Fund contacted KCD after reading the articles. RP 2403, 2689-2690.

Teh brought the articles to the attention of Lori Rastall, who had recently succeeded Larson as KCD's compliance officer. RP 2178, 2179, 2189-2190, 2485-2486, 2490-2491, 2971. Rastall promised to investigate. RP 2179, 2485-2486. Rastall testified that she contacted Gregory, and that Gregory informed her that he had instructed KCD's representatives not to sell the offering to persons who learned of it from the articles (a broader instruction than what Gregory testified his instruction was), had previously asked Westmount Realty Finance to remove the articles from the Westmount website, and that all sales were to clients that had a prior relationship with KCD. RP 2486, 2491, 2495. Rastall did not investigate further, however, to determine if any investors learned of the offering from the articles or if they purchased interests when the articles were on Westmount Realty Capital's website. RP 2495, 2980. Rastall also did not, at the time, investigate whether all of the sales had been to persons who had a pre-existing relationship with the firm. RP 2494, 2495. Rastall did not even carefully read the articles. RP 2487-2488.

Still, Rastall understood that the articles were a violation of the general solicitation prohibition. RP 2487. Rastall did not, however, instruct Gregory that the KCD representatives could not sell the WRF Fund interests. RP 2492-2493. Instead, she told Gregory only that the articles needed to be removed from the website. RP 2486, 2492-2493. Rastall never followed up on that instruction. RP 2493. The articles were never removed from the website. RP 2180.

F. **Sales of the WRF Fund**

The general solicitation materials remained accessible on the Internet and the issuer's website while KCD salespersons sold interests in the WRF Fund, and sales continued until the conclusion of the subscription period. RP 2166, 2433-2434, 2674. Gregory's testimony reflected that the investment process for persons who purportedly had a pre-existing relationship with KCD differed from the process for persons who did not have a pre-existing relationship. Representatives who were contacted by interested persons who had a prior relationship with KCD would provide those persons with the PPM and the LLC agreement. RP 2398. Representatives who were contacted by interested persons who had no prior relationship with KCD would ask the persons how they obtained the representative's contact information; obtain from them a "signed [ac]credited investor form" (RP 2401-2402, 2404-2405); and, as explained above, were instructed to ask how they learned about the offering and, if it was through the newspaper, to not accept reservations from those persons.

Gregory testified that he oversaw the sales team, reviewed for "completeness" the investors' subscription documents and accredited investor forms, and forwarded those materials to KCD for approval. RP 2399, 2405-2406. The first sale of WRF Fund interests occurred on May 5, 2011—just days after the press release and the resulting newspaper articles—and sales continued until after October 2011. RP 2193, 2407, 2441-2442, 2488, 2493, 2672. Ultimately,

KCD sold in excess of $2 million in WRF Fund interests to at least 34 investors. RP 862, 2674, 2676. The WRF Fund was one of KCD's top-three selling private placements during the period that FINRA examined. RP 2164. KCD was entitled to up to 5% of the gross proceeds from all interests sold through its efforts (including a 4% "selling commission" plus a 1% "non-accountable due diligence and marketing allowance") and up to 1/20th of the 20% carried interest distributions that Westmount Realty Finance or its affiliates received. RP 2743, 2752, 2773. As of August 24, 2011, $150,000 in commissions—7.5% of the then-$2 million in sales—was paid to several KCD representatives. RP 2674, 2676. The record does not show the amount of fees paid to KCD by the issuer based on gross proceeds.

## III. PROCEDURAL HISTORY

On November 14, 2013, FINRA's Department of Enforcement ("Enforcement") filed the complaint in this proceeding. RP 1. Cause two—the only cause at issue—alleged that between April and October 2011, KCD sold WRF Fund securities that were neither registered nor qualified for an exemption, in contravention of Section 5 of the Securities Act of 1933 and in violation of FINRA Rule 2010. RP 9-10. Cause two further alleged that KCD did not learn of or investigate the general solicitation of the WRF Fund and, therefore, failed to reasonably supervise the unregistered securities offering, in violation of NASD Rule 3010. RP 9-10.

A FINRA Hearing Panel found that there was a "violation of the registration requirements," that "Section 5 imposes strict liability on those who offer or sell unregistered securities," and that KCD's "failure to stop the unlawful distribution of unregistered securities in the face of a clear duty to do so was an abject failure of [KCD's] supervisory and compliance systems." RP 3490-3491. The Hearing Panel censured and fined KCD $75,000 for those violations. RP 3493-3494.

On appeal, FINRA's National Adjudicatory Council ("NAC") affirmed the findings that KCD sold unregistered securities and failed to supervise those sales. RP 4014-4028. The NAC found that Enforcement demonstrated a prima facie case that KCD sold unregistered securities, and that KCD did not prove that the WRF Fund's distribution qualified for a registration exemption. RP 4019-4025. The NAC also found that "[d]espite KCD's awareness of indications that its representatives were selling unregistered securities that were not exempt from registration," KCD "did not respond with reasonable supervisory steps." RP 4027. The NAC imposed on KCD a censure and a $73,000 fine, within the range of fines recommended by the Guidelines. RP 4028-4033. The NAC found aggravating that KCD disregarded a warning from the issuer's attorney that there had been a breach of the prohibition against general solicitation. This appeal followed. RP 4037-4042.

## IV. ARGUMENT

KCD sold WRF Fund securities that were not registered or exempt from registration, and KCD failed to reasonably supervise the sales of the WRF Fund. Although the issuer claimed it was conducting a private placement, it engaged in a general solicitation of WRF Fund interests in violation of Rule 506, and KCD failed to prove that it sold interests only to the kinds of accredited and sophisticated investors permitted by Rule 506. Contrary to KCD's arguments, the issuer's general solicitations were an "offer" of WRF Fund securities, and the Rule 506 exemption cannot be preserved, after a breach of the general solicitation prohibition, by a firm's post-breach efforts to limit sales to persons with whom it had a pre-existing relationship and who did not see the general solicitations. Instead, as the Commission has indicated, there can be no deviation from the general solicitation ban.

### A. KCD Sold Unregistered Securities That Were Not Exempt from Registration.

Section 5(a) and (c) of the Securities Act of 1933 ("Securities Act") prohibit any person from offering or selling securities unless a registration statement is filed or in effect with the SEC or an exemption from registration is available. 15 U.S.C. § 77e(a) & (c)). A prima facie case of a Section 5 violation requires a showing that "(1) the defendant directly or indirectly sold or offered to sell securities; (2) through the use of interstate transportation or communication and the mails; (3) when no registration statement was in effect." *ACAP Fin., Inc.*, Exchange Act Release No. 70046, 2013 SEC LEXIS 2156, at *28-29 (July 26, 2013), *aff'd*, 783 F.3d 763 (10th Cir. 2015). There is no requirement to show scienter. *Id.* at *29. Once a prima facie case is established, the burden shifts to the person relying on an exemption to establish its availability. *Id.; see SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 12 (D.D.C. 1998) (finding that defendant failed to demonstrate the availability of Rule 506 exemption with sufficient evidence). Evidence in support of an exemption "must be explicit, exact, and not built on mere conclusory statements." *Charles F. Kirby*, 56 S.E.C. 44, 53 (2003). Registration exemptions are strictly construed against the claimant of an exemption. *Id.* at 52.

The NAC correctly found that Enforcement demonstrated a prima facie case of sales of unregistered securities. There is no dispute that KCD representatives sold and offered to sell interests in the WRF Fund, used interstate communication or the mails to do so, that no registration statement was in effect, and that the WRF Fund interests were securities. The burden thus shifted to KCD to demonstrate that the WRF Fund could rely on an exemption. KCD failed to meet that burden.

The WRF Fund's issuer claimed an exemption from registration under Rule 506 of Regulation D. At the time of the offering at issue here, Rule 506 required that, to qualify for an

exemption under Rule 506, offers and sales "satisfy all the terms and conditions of" Rule 502. 17 C.F.R. § 230.506(b) (2011). Rule 502, in turn, required that "neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising."[4] 17 C.F.R. § 230.502(c) (2011). Rule 506 also required that the securities be sold to no more than 35 purchasers who are not accredited investors, and that each purchaser who is not an accredited investor be capable of evaluating the merits and risks of the investment. 17 C.F.R. § 230.506(b) (2011); *see also* 17 C.F.R. § 230.501(e)(1)(iv). As explained below, the Rule 506 exemption was not available because the WRF Fund issuer engaged in a general solicitation, and because KCD failed to demonstrate that the offering complied with the condition concerning the nature of the purchasers.

### 1. The Rule 506 Exemption from Registration Was Not Available Because the Issuer of the WRF Fund Engaged in a General Solicitation.

A violation of the ban on general solicitation occurs where the communications at issue (1) were made or placed by an issuer or person acting on its behalf; (2) offered or sold securities; and (3) were a general solicitation or general advertising. *See Brian Prendergast*, 55 S.E.C. 289, 307 (2001). There is no dispute that the first prong is met: the issuer of the WRF Fund made the press release that directly resulted in the two articles and reprinted those articles on its website. Br. 15. As explained in the following sections, the issuer's press release and its posting of the resulting articles on its website offered securities and were a general solicitation.

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[4] In 2013, the Commission adopted Rule 506(c), which exempts certain offerings that are "not subject to limitation on manner of offering." 17 C.F.R. § 230.506(c). Rule 506(c) does not apply here because it was adopted two years after the WRF Fund offering.

a. **The Communications at Issue Were an "Offer" of Securities.**

The press release and the reprints of the newspaper articles on Westmount Realty Capital's website were an "offer" of securities. KCD's arguments to the contrary lack merit.

Section 2(a)(3) of the Securities Act defines "offer" to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." 15 U.S.C. § 77b(a)(3). Contrary to KCD's attempt to narrowly define the term "offer," it has been given an "expansive interpretation." *Anthony Fields*, Securities Act Release No. 9727, 2015 SEC LEXIS 662, at *21 (Feb. 20, 2015); *Prendergast*, 55 S.E.C. at 308 (discussing the "broad view of 'offer'"). An "offer" includes "communications designed to procure orders for a security, arouse interest in a security, or condition the public mind."[5] *Thoroughbred Racing Stable*, 1976 SEC No-Act. LEXIS 5, at *2 (Jan. 5, 1976) (citing *Carl M. Loeb, Rhoades & Co.*, 38 S.E.C. 843, 848-850 (1959)); *see Securities Offering Reform*, Securities Act Release No. 8591, 2005 SEC LEXIS 1789, at *55 (July 19, 2005) (explaining that "offer" includes publication of information and publicity efforts that "have the effect of conditioning the public mind or arousing public interest in the issuer or in its securities"); *The Regulation of Securities Offerings*, Securities Act Release No. 7606A, 1998 SEC LEXIS 2858, at *227 n.276 (Nov. 13, 1998) ("The Commission has long interpreted 'offer to sell' broadly to encompass pre-filing publicity efforts that may not be phrased expressly in terms of an offer but condition the market

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[5] Citing *Non-Public Offering Exemption*, Securities Act Release No. 4552, 1962 SEC LEXIS 166, at *3 (Nov. 6, 1962), KCD appears to contend that the term "offer" requires a showing that the communication was "for the purpose of ascertaining [which members of the public] would be willing to accept an offer of securities." Br. 15. Nothing in that Securities Act Release suggested, however, that making such a showing was the only way to demonstrate an "offer," and KCD's position has been repeatedly refuted by Commission decisions and SEC guidance.

or stimulate interest in the offering."); *Gearhart & Otis, Inc.*, 42 S.E.C. 1, 26 (1964) (holding that an offer is not limited to communications that "on their face purport to offer a security" but includes communications "designed to procure orders for a security" or "awaken an interest" in securities), *aff'd*, 348 F.2d 798 (D.C. Cir. 1965); *see also Prendergast*, 55 S.E.C. at 307-308 (citing the *Gearhart & Otis* "awaken an interest" standard and finding that communications about hedge funds were used to offer securities where they were designed "to attract investors").

KCD asserts that the articles "were not . . . aimed at investors" but, instead, "owners of distressed property." Br. 16. This is nonsense. Westmount Realty Finance's communications were designed to arouse immediate interest in an available security and condition the public mind. To start with their content, the communications included basic information about the WRF Fund, including its name, issuer, size, and nature. They described the WRF Fund as "a $10 million real estate fund" that would "acquire bank-owned residential properties and nonperforming, discounted residential loans." RP 2663. They included information implying that the fund was a current investment opportunity, stating that the WRF Fund had just been "launched" and that the issuer was a "private investment firm." RP 2663. And when the issuer posted the articles on pages of its unrestricted website that contained a "contact us" link, it provided interested investors with a direct route to contact the issuer for information about the offering. RP 2661, 2663.

The communications also contained positive information about the issuer, the specialized expertise of its business partners, and the issuer's recent history. It described that the issuer's principals "have been in the property business . . . for more than 25 years," that the issuer "is joining with several operators that specialize in bulk acquisition of distressed residential assets," and that "[i]n just over a year, Westmount has purchased more than 530 distressed residential

assets." RP 2661, 2663. Moreover, the articles touted the favorable conditions for purchasing distressed real estate, stating that the United States was "experiencing record-level foreclosure activity," that "most industry experts aren't anticipating a slowdown for at least the next couple of years," that there was a "steady stream of buying opportunities," and that "the firm expects to reinvest sales proceeds in additional assets during the period." RP 2661, 2663. *Cf. SEC v. Thomas D. Kienlen Corp.*, 755 F. Supp. 936, 940-941 (D. Or. 1991) (finding that a notice touting the greater safety, improved performance, and lower costs, of a mutual fund that would be offered "conditioned the public mind" about the fund and was an offer); *SEC v. Arvida Corp.*, 169 F. Supp. 211, 212-215 (S.D.N.Y. 1958) (finding that press releases announcing that securities would be sold at some time in the future and containing an attractive description of the issuer, including favorable descriptions of the real estate market in which it would operate and the issuer's president, constituted an offer).

Indeed, much of the information in the articles was designed to generate investor interest in the fund itself—including forward-looking and optimistic statements about the state of the distressed market—along with enough information to inform interested investors about who to contact. At least one person, after reading the articles, "wanted to invest in the [WRF Fund]" and contacted KCD.[6] RP 2690. That the communications were directed at potential investors is obvious. Even KCD's chief compliance officer stated that the articles were "about a distress [sic] residential fund that Mr. Booth was trying to raise money for." RP 2953.

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[6] Although KCD asserts that "only one potential investor contacted KCD after reading the newspaper articles," the record is not that definitive. Br. 24. Rather, the record shows only that Gregory was aware of one investor who contacted KCD after reading the articles; it does not show if there were others.

The context of the communications further shows how they were designed to arouse investor interest. Westmount Realty Finance generated its press release when the window to raise a significant amount of capital was quickly closing and it had yet to attract any investments. It was one month after KCD began trying to sell interests, before any interests had been sold, and with the deadline to raise the minimum $1,000,000 aggregate subscription quickly approaching. If the minimum subscription was not raised by the deadline, all funds paid by investors, plus interest, had to be returned. RP 2743. The issuer's immediate focus was to raise capital.

The frailty of KCD's position is cemented by the fact that the communications included the same type of information that was in the PPM—a document that is targeted at prospective *investors*—except for the substantial risks. RP 2680. Like the PPM, the communications: (1) described that the size of the fund was $10 million; (2) identified Westmount Realty Finance as the sponsor; (3) explained the fund's plan to acquire distressed residential assets and related assets and partner with specialized operators; (4) discussed the availability of residential assets, although in far more optimistic terms than the PPM did;[7] (5) described the sponsor's other projects; (6) described the experience of the sponsor's management team; and (7) referred to the 12-month period for reinvesting sales proceeds.[8] RP 2743, 2749, 2750, 2752, 2754, 2758, 2760, 2765-2766.

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[7] The PPM stated that "[t]his investment opportunity is made possible by the substantial overflow of distressed assets in the marketplace," but also cautioned that "[t]here may be substantial competition for," and "difficulty in locating," "suitable real estate investments." RP 2749, 2758, 2760.

[8] A communication that includes "factual business information *that does not condition the public mind or arouse public interest in a securities offering*" is not an "offer." *Securities Act Rules Compliance and Disclosure Interpretations*, at Questions 256.24 and 256.25, https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm (emphasis added) (citing *Guidelines for the Release of Information by Issuers Whose Securities Are in*

[Footnote continued on next page]

That there was an "offer" also is consistent with the SEC's broad interpretation of the "offer or sell" requirement. In *Gearhart & Otis*, the SEC found that a respondent offered unregistered securities for sale in violation of Section 5 by sending to securities dealers copies of articles regarding lithium, its uses, availability and commercial prospects. The articles did not mention any particular security or company. Nonetheless, the SEC found that sending the articles to the dealers was part of a scheme to "awaken an interest" in lithium securities shortly before the offering of securities in National Lithium Corporation and part of a "campaign to sell . . . stock." *Gearhart & Otis*, 42 S.E.C. at 26. In *Prendergast*, a representative placed a newspaper advertisement inviting the general public to seminars about hedge funds. The advertisement did not mention a specific hedge fund but was placed during the time the representative was selling units in a specific hedge fund. Although the only evidence about the content of the seminar was that it was "generic," there also was evidence that the purpose of the seminar was to attract investors to the hedge fund. The SEC found that the advertisement and the seminar itself were designed to attract investors, used to offer or sell units in the hedge fund, and violated the general solicitation ban. *Prendergast*, 55 S.E.C. at 307-308. Compared to the generic communications in *Gearhart & Otis* and *Prendergast*, Westmount Realty Finance's actions present a stronger example of an offer. The newspaper articles and the press release mentioned a specific, current securities offering, its sponsor, specific information about the managers of the fund, and positive, forward-looking, optimistic information about the business

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*Registration*, Securities Act Release No. 5180, 1971 SEC LEXIS 29 (Aug. 16, 1971)). While the communications about the WRF Fund included some factual business information, it was presented in such a manner to arouse investor interest in the WRF Fund and, thus, offer the WRF Fund.

market in which the fund operated.[9] The communications were designed to arouse interest in the WRF Fund and were an offer.

**b. The Communications Were Widely Disseminated and Constituted a General Solicitation.**

The communications at issue met the definition of general solicitation, given the manner in which they were disseminated. Rule 502(c) provides that the terms "general solicitation" and "general advertising" include, but are not limited to, "[a]ny . . . article, notice or other communication published in any newspaper, magazine, or similar media." 17 C.F.R. § 230.502(c). The newspaper articles resulted from a press release that Westmount Realty Finance issued, and it posted the articles on its unrestricted web site. Press releases and publicly available media, such as articles on an unrestricted, publicly available website, are general solicitations or general advertisements. *Remco Sec., Inc.*, 1985 SEC No-Act. LEXIS 2455, at *2 (Aug. 20, 1985); *Securities Act Rules, Compliance and Disclosure Interpretations, supra,* Question 256.23; *Use of Electronic Media for Delivery Purposes*, Securities Act Release No. 7233, 1995 SEC LEXIS 2662, at *35 (Oct. 6, 1995); *Use of Electronic Media*, Securities Act Release No. 7856, 2000 SEC LEXIS 847, at *55-56 (Apr. 28, 2000); *SEC v. Rabinovich & Assoc.*, No. 07 Civ. 10547, 2008 U.S. Dist. LEXIS 93595, at *13 (S.D.N.Y. Nov. 17, 2008) (holding that general solicitation of purchases by means of a website precluded a registration exemption).

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[9] KCD argues that the articles "did not include anything to indicate that there were opportunities for investors in the WRF Fund." Br. 2. As *Gearhart & Otis* demonstrates, whether a communication constitutes an "offer" of a security does not require that the communication, on its face, purport to offer a security. 42 S.E.C. at 26.

Moreover, to avoid making a general solicitation, in most cases a substantive relationship must exist between the issuer or its agents and the offerees before the solicitation of such offerees. *H.B. Shaine & Co.*, 1987 SEC No-Act. LEXIS 2004, at *1 (May 1, 1987); *see also Robert T. Willis, Jr., P.C.*, 1988 SEC No-Act. LEXIS 34, at *2 (Jan. 18, 1988) (staff interpretation that "[i]f interests in [securities] are offered to persons who may not have had a prior existing relationship with the issuer, we would be unable to conclude that there would be no general solicitation for purposes of Rule 502(c)"); *E.F. Hutton & Co.*, 1985 SEC No-Act. LEXIS 2917, at *1-2 (Dec. 3, 1985) (staff interpretative letter stating that substantive, pre-existing relationships with offerees demonstrate that a general solicitation did not occur). Here, the WRF Fund issuer's communications, which were generally accessible, were directed at the general public, not just at persons with whom the issuer had a pre-existing, substantive relationship.

**c. The Rule 506 Registration Exemption Cannot Be Preserved, After a Breach of the General Solicitation Prohibition, Through Post-Breach Efforts to Limit Sales of Unregistered Securities.**

For all of the reasons stated above, Westmount Realty Finance's press release and its posting of the resulting newspaper articles on its website was an offer and a general solicitation. KCD argues that, even if the press release and newspaper articles constituted an offer, the prohibition against general solicitation was not violated because KCD "did not use" the communications to offer or sell the WRF Fund. Br. 14, 17-18. In this regard, KCD claims that it took steps, after the breach of the general solicitation ban, to ensure that interests were sold only to accredited investors with whom KCD had a prior existing relationship and who had not seen the articles. Br. 14, 19. KCD's argument is supported by neither the law nor the facts.

### i. Limiting Sales of Unregistered Securities to Persons with Whom KCD Had a Pre-Existing Relationship and Who Did Not See the Issuer's General Solicitation Does Not Preserve the Rule 506 Exemption.

KCD's argument that it took post-breach efforts to limit sales only to persons with whom it had a pre-existing relationship and who did not see the general solicitation seeks to restrict the relevant analysis to only the persons who were sold WRF Fund securities. This is a mistake. Whether there has been a general solicitation looks to who was *offered* securities. *See* Rule 502(c) (providing that neither the issuer nor any person acting on its behalf may "offer or sell" the securities by any form of general solicitation); *SEC v. Murphy*, 626 F.2d 633, 644-45 (9th Cir. 1980) ("The party claiming the [private offering] exemption must show that it is met not only with respect to each purchaser, but also with respect to each offeree."); *Use of Electronic Media*, 2000 SEC LEXIS 847, at *57-58 (stating the "important and well-known principle" that "a general solicitation is not present when there is a pre-existing, substantive relationship between an issuer, or its broker-dealer, and the *offerees*") (emphasis added); *see also Non-Public Offering Exemption*, 1962 SEC LEXIS 166, at *2-3 (stating that, when analyzing whether a transaction is not a public offering and therefore exempt from registration, "[c]onsideration must be given not only to the identity of the actual purchasers but also to the offerees" and that "general solicitations of an unrestricted and unrelated group of prospective purchasers . . . is inconsistent with a claim that the transaction does not involve a public offering *even though ultimately there may only be a few knowledgeable purchasers*") (emphasis added).

Moreover, strict compliance with the general solicitation prohibition is required to preserve the Rule 506 exemption. Rule 508(a)(2) of Regulation D provides that the failure to comply with the general solicitation prohibition is deemed to be significant to the offering as a whole. *See* 17 C.F.R. § 230.508(a)(2). When adopting Rule 508, the Commission rejected

giving relief even to so-called minor violations of the general solicitation prohibition. It explained that the prohibition was one of the "critical elements to a Regulation D exemption" from which "there cannot be any deviation." *Notice of Proposed Rulemaking*, Securities Act Release No. 6759, 1988 SEC LEXIS 388, at *10-11 (Mar. 3, 1988) ("[U]nder Regulation D, limited offerings are contemplated and no general solicitation or advertising would be consistent with the exemptions provided."); *cf.* Stuart R. Cohn, *Securities Markets for Small Issuers: The Barrier of Federal Solicitation and Advertising Prohibitions*, 38 Univ. Fla. L. Rev. 1, 6 (Winter 1986) (explaining that "no amount of good faith, disclosure or caution will prevent the denial or loss of a registration exemption if the issuer or underwriter has violated the prohibition against general solicitation").

Contrary to KCD's contention (Br. 14), the Division of Corporation Finance's 1983 *Interpretive Release on Regulation D* ("1983 Interpretive Release") does not hold that limiting sales to persons with whom KCD had a pre-existing relationship prevents the loss of the Rule 506 exemption that results from a general solicitation. That release stated that the "two separate inquiries" under Rule 502(c) are "is the communication in question a general solicitation or general advertisement?" and "if it is, is it being used by the issuer or by someone on the issuer's behalf to offer or sell the securities?" *See* Securities Act Release No. 6455, 1983 SEC LEXIS 2288, at *45 (Mar. 3, 1983). The 1983 Interpretive Release does not state that a registration exemption that would otherwise be lost through a breach of the general solicitation prohibition could be preserved through post-breach efforts to limit sales to persons who have a pre-existing relationship with the firm.[10]

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[10] In its most favorable light, the 1983 Interpretive Release suggests only that evidence of how a communication will be used could be germane to whether the communication is a general

[Footnote continued on next page]

KCD also misplaces its reliance on the 2007 *Revisions of Limited Offering Exemptions in Regulation D* ("2007 Regulation D Guidance"). Br. 17-18. In that notice, the Commission provided guidance concerning questions about the ability of issuers to conduct a private placement before a registration statement is filed or in the period between the filing and effectiveness of the registration statement. *See* Securities Act Release No. 8828, 2007 SEC LEXIS 1730, at *85 (Aug. 3, 2007). Recognizing that "capital raising around the time of a public offering . . . often is critical if companies are to have sufficient funds to continue to operate while the public offering process is ongoing," the Commission provided guidance about the narrow question of when a "registration statement could serve as a general solicitation or general advertising for a concurrent private offering." *Id.* at *85-86, 89-90. Nothing in the 2007 Regulation D Guidance suggests that it was intended to apply outside the narrow context of concurrent public and private offerings.

KCD also cites a 2011 letter authored by Chairperson Mary Schapiro ("Schapiro Letter"). Br. 13, 18. The Schapiro Letter was written in the aftermath of the decision of Facebook and Goldman Sachs & Co. to limit a $1.5 billion private placement of Facebook securities only to investors outside the United States due to the level of media coverage of the offering inside the

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solicitation. *Id.* at *46 (explaining that Commission staff previously declined to opine on whether a proposed tombstone advertisement that would announce the completion of an offering was a general solicitation, where the announcement "could be an indirect solicitation for a new offering" but where the requesting letter did not describe its proposed use). Unlike the example in the 1983 Interpretive Release, it is clear that Westmount Realty Finance's communications, based on their content and context, were designed to arouse interest in, and condition the market for, a current securities offering. Furthermore, Westmount Realty Finance made the communications at issue, not KCD, and KCD proffered no evidence showing that Westmount Realty Finance planned for its communications to serve some purpose other than arousing investor interest.

United States. *See Letter dated April 6, 2011, from SEC Chairperson Mary L. Schapiro to The Honorable Darrell E. Issa*, at p. 8, https://www.sec.gov/news/press/schapiro-issa-letter-040611.pdf. Broadly interpreting the 2007 Regulation D Guidance, Chairperson Schapiro wrote that the Commission previously "indicated that the proper analysis of whether a general solicitation occurred focused on whether the investors participating in the offering were actually solicited through the activities which could be viewed as a general solicitation or if, for example, the investors were existing clients or those with whom a pre-existing relationship existed." *See id.*

The circumstances described in the Schapiro Letter, however, are different than those at issue here. The Schapiro Letter does not state that Facebook or Goldman Sachs were the prime movers of the media coverage that could have been viewed as a general solicitation. In contrast, Westmount Realty Finance intentionally generated the press release, further distributed the resulting media coverage through its unrestricted website, and refused to comply with KCD's request that it remove the articles from its website. Moreover, the Schapiro Letter is not binding authority.[11]

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[11] KCD also argues that *Joseph P. Doxey*, Exchange Act Release No. 77773, 2016 SEC LEXIS 1665 (May 5, 2016), "suggest[s]" that if a respondent can show "that it had a prior existing relationship with the investor, there would be no general solicitation violation despite the issuance of press releases regarding issuer." Br. 17-18 n.94. The Commission's analysis, however, said only that a substantive relationship between the issuer and a purchaser of unregistered securities that pre-existed the offers and sales would be a means of demonstrating compliance with the general solicitation prohibition. *Doxey*, 2016 SEC LEXIS 1665, at *27-28. *Doxey*'s analysis of the potential registration violations did not address the press releases that were discussed in a different section of the order, address whether those press releases breached the general solicitation ban or, if so, whether a pre-existing relationship between the seller and the purchaser preserved the availability of a registration exemption. Moreover, *Doxey*'s value is even more limited given its context: the denial of the Division of Enforcement's motion for summary disposition in favor of a pro se respondent.

For these reasons, a firm's efforts after a breach of the general solicitation prohibition to limit sales to persons with whom the firm has a pre-existing relationship and who did not see the general solicitation do not preserve the Rule 506 exemption. Instead, as the Commission had stated, the general solicitation ban is something from which no deviation is permitted.

**ii. KCD Did Not Prove That It Sold WRF Fund Interests Only to Persons with Whom It Had a Pre-Existing Relationship and Who Had Not Seen the Issuer's General Solicitation.**

On equally important factual grounds, the NAC correctly found that KCD did not prove with sufficient evidence that the only persons to whom it sold WRF Fund interests were persons solicited through legitimate means and pre-existing clients.

In an on-the-record interview, Rastall, KCD's chief compliance officer, admitted that she "did not confirm whether or not [the people who purchased the WRF Fund] had seen the article on the website" and that it was "possible" they had. RP 2982. Rastall similarly conceded at the hearing that she "didn't check then, and [doesn't] know now, if any of those people . . . who supposedly had a preexisting relationship [with KCD] . . . learned about the offering as a result of these articles." RP 2495.

Regarding whether WRF Fund interests were sold only to pre-existing clients, Rastall testified that they were, but she admitted that, at the time she learned about the general solicitation, she "didn't, as the [chief compliance officer], go and check to make sure that the people who actually purchased were people that had a preexisting relationship." RP 2494-2495, 2982. Rather, Rastall claimed that, only in preparation for the hearing, she had finally "cross-referenced our files" and discovered that "[a]ll of the sales were done with clients that had a previous existing relationship with the firm." RP 2486-2487, 2495. But the record contains no documentation of her purported review. RP 2495. Absent corroborating evidence, Rastall's

testimony that all of the investors were pre-existing clients deserves no weight, especially considering that she provided false information to FINRA staff regarding related issues. In this regard, on two occasions prior to the hearing—first in response to FINRA's 2011 examination findings and again at her on-the-record interview—Rastall falsely informed FINRA staff that the articles were removed from the Westmount website and that KCD was monitoring that website. RP 2179-2180, 2496-2497, 2597, 2963-2964, 2976. The articles, however, were never removed from the website, and Rastall ultimately admitted at the hearing that she never checked whether the articles had been removed. RP 2180, 2486, 2496-2497.

Gregory's testimony also does not suffice to demonstrate that no investors in the WRF Fund saw the general solicitation materials or that WRF Fund interests were sold only to pre-existing clients. Gregory testified that he instructed the KCD representatives to ask interested persons with whom KCD did not have a pre-existing relationship how they learned about the WRF Fund offering and, if the answer was "I read about it in an article in the paper," to not permit those persons to invest. RP 2401-2402. Gregory's testimony left it unclear, however, whether he directed KCD's representatives to ask a similar question of persons with whom KCD *did* have a pre-existing relationship. Moreover, Gregory conceded that, at the time he instructed KCD's representatives about the newspaper articles, he was not aware that the articles had also been posted to the Westmount Realty Capital website, and there is no evidence that Gregory ever instructed KCD's representatives to ask potential investors if they read anything about the WRF Fund on the website. RP 2401-2402. Furthermore, Gregory did not testify about any steps he took to investigate whether any investors had learned of the offering through the press release, the resulting articles, or the Westmount website. Instead, Gregory's view that no investors had learned of the offering from the general solicitation appeared to rest only on the facts that he

gave limited instructions to KCD's representatives about the newspaper articles and was aware of only one investor who had responded to the articles. RP 2403.

Gregory's summary testimony that all sales of WRF Fund interests were only to investors with whom KCD had a prior existing relationship also is insufficient to establish that fact. RP 2435. It is not corroborated with any documentation. It is not corroborated by Rastall's testimony, for the reasons explained above. It is undermined by the fact that KCD did not initially take the position that interests had been sold only to pre-existing clients.[12] And, like Rastall, Gregory did not always provide reliable information about relevant facts. When Gregory testified about his conversation with the issuer's securities attorney, he stated that "I don't remember [the securities attorney] black-and-white saying this [i.e., the newspaper articles] is absolutely a breach of general solicitation" but recalled only that the attorney had expressed concern and that it "could be a breach." RP 2409, 2418-2419, 2421. In a letter written closer to the relevant events, however, Gregory wrote, with no qualifications, that the attorney "made us aware of the breach of general solicitation." RP 2689.

The insufficiency of KCD's proof comes into sharp relief when evidence that raises questions about whether KCD failed in other ways to limit offers of the WRF Fund to persons with whom KCD had a pre-existing relationship is considered. Gregory conceded that some investors were not pre-existing clients of KCD or Westmount Realty Finance but were "clients of registered investment advisors" that, in turn, were purportedly KCD's pre-existing clients. RP 2435. Whether KCD's offering of interests to the clients of an investment adviser are a general solicitation, however, depends on the nature and extent of the pre-existing relationship between

[12] In its March 21, 2012 response to FINRA's 2011 examination of the firm, KCD did not state that all sales of interests in the WRF Fund had been only to pre-existing clients. RP 2597.

KCD and the investment advisers and between the investment advisers and their clients. *See Royce Exchange Fund, Quest Advisory Corp.*, 1996 SEC No-Act. LEXIS 706, at *1-2 (Aug. 28, 1996) (emphasis added). There is little evidence of the nature and extent of the relationship between KCD and its investment adviser clients, other than that one investment adviser "maybe . . . had ten clients invested in the previous offering." RP 2435. And what little evidence exists concerning the relationship between the investment advisers and their clients—Gregory testified that one of the WRF Fund investors could have been a "new client" of one of the investment advisers—suggests that KCD may have generally solicited the clients of the investment advisers. RP 2435.

KCD failed to offer more specific evidence that the WRF Fund investors did not learn of the offering from the general solicitation materials and that interests were sold only to pre-existing clients. What little evidence KCD proffered on these issues was only general, built on conclusory statements, and insufficient. Proof of an exemption "must be explicit, exact, and not built on mere conclusory statements." *Kirby*, 56 S.E.C. at 52; *cf. Lively v. Hirschfeld*, 440 F.2d 631, 632-633 (10th Cir. 1971) (holding that testimony that made "general references to . . . buyers and offerees" and "without reference to particular persons" was insufficient to prove nonpublic offering exemption); *V.F. Minton Sec., Inc.*, 51 S.E.C. 346, 352 (1993) (finding that an interested party's "bare conclusions" that all requirements for the Rule 144(k) exemption had been met was insufficient to demonstrate a registration exemption); *Dale Dwight Schwartzenhauer*, 50 S.E.C. 1155, 1158 (1992) (finding that respondent's "self-serving accounts" that he did not act as an underwriter was insufficient to establish Section 4(1) registration exemption).

Accordingly, the NAC correctly found that the Rule 506 exemption was not available because the issuer of the WRF Fund engaged in a general solicitation of the WRF Fund.

### 2. The Rule 506 Exemption Was Not Available Because KCD Failed to Demonstrate that It Sold the WRF Fund Only to Persons Who Met the Rule 506 Limitations on Purchasers.

The NAC also properly found that KCD failed to demonstrate that the WRF Fund offering qualified for the Rule 506 exemption because KCD did not prove that the offering was sold only to accredited investors or persons who met the sophistication criteria of Rule 506(b).

In support of its argument that it sold WRF Fund interests only to accredited investors, KCD relies on Gregory's and Rastall's testimony. Gregory summarily testified that KCD verified that the investors were accredited, and Rastall summarily testified at her on-the-record interview that she confirmed that the investors were accredited. RP 2388, 2405, 2982. The NAC properly gave that testimony no weight. Gregory's and Rastall's testimony that the investors were accredited was conclusory in nature. And KCD did not submit any evidence corroborating their testimony. This does not suffice when trying to demonstrate an exemption from the registration requirements. *See Kirby*, 56 S.E.C. at 53. This is all the more so here, given that, as explained above, Rastall and Gregory both provided statements during FINRA's examination and proceedings that were not reliable.

KCD's failure to introduce corroborating evidence is entirely its own fault. Under its soliciting dealer agreement, KCD agreed to "retain in [its] records" "information establishing that each person who purchases the Interests . . . is within the permitted class of investors," which the PPM indicated was "individuals or entities . . . that meet the definition of an 'accredited investor' as set forth in Regulation D." RP 2680, 2747. Pursuant to the PPM, each prospective investor was required to "represent[ ] that he is accredited." RP 2747. Gregory

testified that he provided documentation to KCD that purportedly documented the investors' accredited investor status and reviewed those documents just to make sure they were "complete." RP 2405-2406. Yet KCD did not introduce any of this documentation. *Cf. SEC v. Credit First Fund, LP*, No. CV05-8741, 2006 U.S. Dist. LEXIS 96697, at *45-46 (C.D. Cal. Feb. 13, 2006) (finding that Rule 506 exemption was likely not available where defendants failed to submit completed investor suitability questionnaires to support claim that there were no more than 35 non-accredited investors in the offering); *Mark v. FSC Sec. Corp.*, 870 F.2d 331, 336-337 (6th Cir. 1989) (stating that defendants failed to meet burden of demonstrating the availability of Rule 506 where they did not proffer executed subscription documents of all investors or specific testimony by an issuer official that securities were sold only to investors whose offeree questionnaires indicated they qualified under Rule 506 as purchasers).[13]

KCD also advances a flawed argument premised on an inaccurate paraphrasing of, and baseless presumptions about, FINRA examiner Teh's testimony. KCD inaccurately asserts that Teh testified that he "determined that the sales were suitable" and, from that, presumes that Teh determined that all of the investors were accredited. Br. 10; NOA 4. What Teh actually testified was that he reviewed a sample of the investors in the WRF Fund, that he "didn't have any findings in [the] review" concerning suitability, and that he found "nothing unsuitable." RP

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[13] Although KCD relies on *James F. Glaza*, Initial Decisions Release No. 293, 2005 SEC LEXIS 1798 (ALJ July 21, 2005) (cited at Br. 21), Glaza proffered substantial, material evidence to demonstrate that investors were accredited. Among other things, Glaza proffered: (1) his own testimony that his broker-dealer informed him the offering was legally sufficient; (2) the testimony of the persons who "reviewed each subscription agreement," "evaluated whether the investor was accredited," and "approved the subscription agreements"; (3) the testimony of an attorney who had reviewed the offerings for compliance with registration exemptions; and (4) some executed subscription agreements that were consistent with the respondent's claim that the investors were accredited. *Id.* at *13-17.

2197-2198. Moreover, Teh was not asked if he examined whether the investors were accredited investors, and he did not testify that any or all of the investors were accredited investors.

Because of its insufficient evidence, KCD failed to prove that the WRF Fund offering complied with the Rule 506 exemption, and the NAC correctly found that KCD sold unregistered securities without the benefit of an available exemption in contravention of Section 5 of the Securities Act and FINRA Rule 2010. The Commission should sustain the NAC's findings.

### B. KCD Failed to Supervise Its Representatives' Sales of Unregistered Securities.

The record also supports the NAC's findings that KCD failed to supervise its representatives' sales of WRF Fund interests. NASD Rule 3010(a) requires that "[e]ach member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules."[14] The rule also states that "[f]inal responsibility for proper supervision shall rest with the member." The duty to supervise requires "reasonable" supervision, which is "determined based on the particular circumstances of each case." *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008). It "includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation." *Id.* (quoting *Michael T. Studer*, 57 S.E.C. 1011, 1023-24 (2004), *aff'd*, 260 F. App'x 342 (2d Cir. 2008)); *ACAP Fin., Inc.*, 2013 SEC LEXIS 2156, at *33 (red flags and suggestions of irregularities in Section 5 case demanded inquiry, follow-up, and review); *La*

[14] Since the relevant period, NASD Rule 3010 has been renumbered as FINRA Rule 3110.

*Jolla Capital Corp.*, 54 S.E.C. 275, 285 (1999) ("Once indications of irregularity arise, supervisors must respond appropriately.").

KCD had relevant supervisory procedures that identified the supervisors for private offerings and required them, throughout the offering, to perform reasonable due diligence and monitor for Regulation D compliance. RP 2182-2183, 2728. Those responsibilities were assigned, under the procedures in force in March 2011, to KCD's president and owner, Joel Blumenschein, and KCD's chief compliance officer, Larson. RP 1923, 2085-2086, 2182-2183, 2728. While the record does not contain the supervisory procedures in force when Rastall became chief compliance officer, the record reflects that Rastall became involved in KCD's handling of the general solicitation issue. In addition, Gregory was in charge of overseeing the KCD representatives who sold the WRF Fund offering, was involved in handling the general solicitation issue, and had the authority to halt sales.

Early in the offering period, Gregory and Larson became aware of the potential problems with sales of the WRF Fund. The issuer's attorney informed Gregory that the general solicitation ban had been breached, recommended that Westmount Realty Finance publish a rescission of the newspaper article, and advised that the articles not be published on Westmount's website. RP 2399, 2689. Gregory assumed, "[b]ased on my conversation with our securities attorney," that the articles were a breach of the general solicitation ban and understood that a press release about the offering would render the offering non-exempt. RP 2409, 2424. Gregory, in turn, informed Larson about the conversation with the issuer's securities attorney. RP 2400-2401, 2422. Just days after these events, Gregory learned that the newspaper articles had been posted on Westmount's website—precisely what the attorney had warned against. RP 2170, 2174, 2402, 2403.

Despite its early awareness of the breach of the general solicitation prohibition, KCD did not instruct representatives to stop selling interests in the WRF Fund. Instead, Gregory only informed KCD representatives about the newspaper articles and gave them limited instructions on how to proceed. He instructed the representatives to ask interested investors who did not have a prior business relationship with KCD or the sponsor how they learned about the WRF Fund and, if it was through the "newspaper," to not allow those persons to invest. RP 2401-2402. These instructions did not inform the representatives about the materials on the web site, or instruct the representatives to ask persons with whom there was a pre-existing relationship about whether they had seen the general solicitation materials. Gregory also testified that he asked Westmount Realty Finance to remove the articles from the website but never verified that that happened. RP 2425-2426. Had he followed up, Gregory would have learned that although the KCD representatives continued to sell the WRF Fund, the newspaper articles remained on the unrestricted website, generally accessible by the public. RP 2425-2426.

KCD's supervisory failures continued when, several months later, FINRA staff alerted Rastall and Blumenschein about the newspaper articles that were still available on the Internet. RP 2178, 2180-2181, 2582-2583, 2594, 2606-2607, 2618. Rastall understood that the articles constituted a general solicitation in violation of Regulation D and should not have been on the website during the solicitation stage of a private offering. RP 2487, 2498, 2955, 2963-2964, 2974-2975. As further evidence of their understanding of the problem, neither Rastall nor Blumenschein disputed that a general solicitation had occurred or contended that a general solicitation did not occur, either when FINRA staff initially shared its concerns with them or when KCD formally responded to FINRA's examination report. RP 2178, 2181.

KCD still did not reasonably respond. Rastall did not instruct Gregory that KCD could not sell the offering. RP 2492-2493. Instead, Rastall only instructed Gregory that the articles needed to be removed from the Westmount website, and then never followed up on even that insufficient instruction, despite knowing of Gregory's earlier, unsuccessful attempt to have the articles removed. RP 2486, 2493. Had Rastall checked, she would have learned that the articles still remained on the website and that KCD permitted its representatives to continue sell the offering while it was being generally solicited. KCD had the power to halt sales of the WRF Fund but never did so. RP 2425-2427. Because KCD confronted a red flag and did not respond appropriately, it failed to supervise the sales of the WRF Fund, in violation of FINRA rules.

Citing the Schapiro Letter, KCD argues that it did not need to halt sales to reasonably supervise, but only needed to ensure that WRF Fund securities were sold to accredited investors who learned about the offering from means other than the general solicitation materials. Br. 23. As explained above, a breach of the general solicitation prohibition cannot be cured by limiting sales to the kinds of investors who are permitted to invest in Rule 506 offerings and who did not see the general solicitation. In any event, KCD did not even take sufficient supervisory steps to ensure that WRF Fund interests were sold only to accredited investors who learned about the offering from means other than the general solicitation.

As explained above, Gregory's instructions to KCD representatives were not broad enough to reasonably ensure that WRF interests would not be sold to interested investors who read the general solicitation materials. Likewise, Rastall took no steps to confirm that KCD sold WRF Fund securities only to persons who learned about the offering from means other than the general solicitations. In an on-the-record interview, Rastall conceded that she "didn't do anything . . . to determine whether there were sales . . . to people who had seen th[e] article,"

"did not confirm whether or not [the people who purchased the WRF Fund] had seen the article on the website," and that it was "possible" that "investors had seen the article on the website." RP 2980, 2981, 2982. Rastall likewise conceded that she lacked personal knowledge about whether any KCD representatives knew that the articles were on the website or, if so, when they knew that. RP 2970. And at the hearing, Rastall admitted that she "didn't check then, and [doesn't] know now, if any of those people . . . that supposedly had a preexisting relationship [with KCD] . . . learned about the offering as a result of these articles."[15] RP 2495.

KCD's lack of supervision or follow-up concerning the breach of the general solicitation prohibition was a consistent theme. Despite learning about the newspaper articles, no one at KCD put any information about them in KCD's due diligence files, and Rastall had no awareness of the articles until FINRA staff brought them to her attention. RP 2182, 2193. Gregory testified that he did not recall if he had asked the securities attorney whether the KCD representatives should not sell the offering. RP 2437. Rastall claims to have personally investigated whether the WRF Fund investors were persons with whom KCD had a pre-existing relationship, but she concedes that she did not do so until the lead-up to the hearing, which was years after the relevant events, and provided no corroborating documentation of that purported review. RP 2486-2487, 2495. Even more than three years after learning of the newspaper articles, Rastall had still not "carefully reviewed" them. RP 860, 2487-2488.

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[15] The mere fact that Gregory was aware of one interested investor who contacted KCD after reading the newspaper articles is not evidence that KCD limited sales only to persons who had not seen the general solicitation. To the contrary, KCD did not ask existing customers about viewing the general solicitation or verify that the persons who invested had not seen the general solicitation, and therefore failed to show that each investor had not seen the general solicitation.

For the reasons explained above, KCD failed to supervise the sales of the WRF Fund securities in violation of NASD Rule 3010 and FINRA Rule 2010. The SEC should sustain the findings of violation.

### C. FINRA's Sanctions Are Appropriate to Remedy KCD's Sales of Unregistered Securities and Its Supervisory Failures.

The NAC imposed a censure and a $73,000 fine on KCD for its selling of unregistered securities and failure to supervise. These sanctions are appropriately remedial and consistent with the FINRA Sanction Guidelines ("Guidelines").[16]

For sales of unregistered securities, the Guidelines recommend imposing a fine between $2,500 and $73,000 and disgorgement. In egregious cases, the Guidelines recommend a higher fine and a suspension of the firm with respect to any or all activities or functions for up to 30 business days or until procedural deficiencies are remedied.[17] For failing to supervise, the Guidelines recommend a fine between $5,000 and $73,000 and limiting the activities of the appropriate branch office or department for up to 30 business days. In egregious cases, the Guidelines recommend limiting activities for a longer period or suspending the firm with respect to any or all activities or functions for up to 30 business days.[18]

There are several aggravating factors concerning KCD's sales of unregistered securities. KCD raised between $2.0 to $2.5 million for the WRF Fund.[19] RP 862, 2676. Despite

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16 *FINRA Sanction Guidelines* (2015) [hereinafter Guidelines]. A copy of the relevant Guidelines are attached as Attachment A. The Guidelines were updated in October 2016, but the changes are not relevant here.

17 *Id.* at 24.

18 *Id.* at 103.

19 *Id.* at 24 (Principal Considerations in Determining Sanctions, No. 3).

acknowledging in the soliciting dealer agreement that "no general solicitation will be permitted" (RP 2682), KCD disregarded red flags that it was selling unregistered securities that did not qualify for an exemption, including the communication from the issuer's securities attorney that the general solicitation prohibition had been breached and KCD's awareness that the newspaper articles had been posted on the issuer's website.[20] KCD did not implement reasonable supervisory steps to prevent violations.[21] KCD's misconduct resulted in monetary gain.[22]

Likewise, there are several aggravating factors surrounding KCD's supervision violations. The nature, extent, size and character of the underlying misconduct—millions of dollars of sales of unregistered securities—is aggravating.[23] KCD disregarded red flags that it was selling unregistered securities that did not qualify for an exemption.[24] The quality and degree of the supervisors' implementation of the firm's supervisory procedures and controls was weak.[25]

The NAC also was rightly concerned about whether Rastall's conduct during FINRA's investigation was a harbinger of future, additional misconduct. As described above, Rastall—whom CRD indicates remains KCD's chief compliance officer—provided misleading information to FINRA staff concerning KCD's new procedures for checking the issuer's web site

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20 *Id.* at 24 (Principal Considerations in Determining Sanctions, No. 5).

21 *Id.* at 24 (Principal Considerations in Determining Sanctions, No. 4).

22 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 17).

23 *Id.* at 103 (Principal Considerations in Determining Sanctions, No. 2).

24 *Id.* at 103 (Principal Considerations in Determining Sanctions, No. 1).

25 *Id.* at 103 (Principal Considerations in Determining Sanctions, No. 3).

for evidence of a general solicitation and their implementation.[26] On two occasions prior to the hearing, Rastall falsely informed FINRA staff that the articles were removed from the Westmount website and that KCD was monitoring that website. RP 2179-2180, 2496-2497, 2597, 2963-2964, 2976. In fact, the articles were never removed from the website, and Rastall admitted at the hearing that she never checked whether the articles had been removed. RP 2180, 2486, 2496-2497.

There are also, as the NAC found, some mitigating factors. The post-breach instructions that Gregory gave to KCD's representatives reflected an attempt to comply, at least in part and before FINRA detected the misconduct, with the requirements of Rule 506.[27] Considering KCD's actions in this regard, KCD's conduct was reckless—still a serious state of mind—but not intentional.[28]

There are no other mitigating factors. KCD argues that its handling of the WRF Fund "represented a unique circumstance" and that there is "no evidence . . . that KCD engaged in a pattern or practice of selling unregistered securities without an exemption." NOA 5. But KCD's violative sales of WRF Fund securities lasted months and involved supervisory failures by several persons.

Citing the Guidelines' Principal Consideration 11, KCD argues that the purported lack of customer harm is mitigating. NOA 5; *Guidelines*, at 6. While Enforcement did not prove that

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[26] *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 12) (directing consideration of whether, during FINRA's examination or investigation, the respondent provided inaccurate or misleading information).

[27] *Id.* at 6 (Principal Considerations in Determining Sanctions, No. 4), 24 (Principal Considerations in Determining Sanctions, No. 1).

[28] *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 13).

there was customer harm, KCD did not prove that there was no customer harm. In any event, certain of the Guidelines' principal considerations—like Principal Consideration 11—"have the potential to be only aggravating," in which case the absence of the specified factors "does not draw an inference of mitigation." *Guidelines*, at 6. As the Commission has explained, the absence of customer harm is not mitigating because the public interest analysis focuses on the welfare of investors generally. *Howard Braff*, Exchange Act Release No. 66467, 2012 SEC LEXIS 620, at *26 (Feb. 24, 2012); *see also Dep't of Enforcement v. Mizenko*, Complaint No. C8B030012, 2004 NASD Discip. LEXIS 20, at *20 (NASD NAC Dec. 21, 2004) ("[T]here is no authority for the proposition that the absence of harm to customers is mitigating."), *aff'd*, 58 S.E.C. 846 (2005).

KCD also argues that the NAC's fine bears no relation to sanctions imposed by the Commission on respondents who were found to have violated the prohibition on general solicitation. Br. 27-30. The Commission, however, has consistently held that the appropriateness of the sanctions "depends on the facts and circumstances of the particular case and cannot be determined precisely by comparison with action taken in other cases." *Dennis S. Kaminski*, Exchange Act Release No. 65347, 2011 SEC LEXIS 3225, at *41 (Sept. 16, 2011). KCD's attempt to compare the sanctions to those imposed in various settled cases likewise fails. Such comparisons "are inappropriate because pragmatic considerations justify the acceptance of lesser sanctions in negotiating a settlement" whereas "[l]itigated cases typically present a fuller, more developed record of facts and circumstances for purposes of assessing appropriate sanctions." *Kent M. Houston*, Exchange Act Release No. 71589, 2014 SEC LEXIS 614, at *33 (Feb. 20, 2014) (citing cases; internal quotation marks omitted).

The Commission also should reject KCD's attempts to minimize the general seriousness of selling unregistered securities that did not qualify for the Rule 506 exemption. Br. 27-30. "'The registration requirements are the heart' of the Securities Act," which was "designed 'to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.'" *ACAP Fin., Inc.*, 2013 SEC LEXIS 2156, at *28 (citing, *inter alia*, *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953)). The general solicitation prohibition, originally adopted in 1974 as part of a predecessor rule,[29] serves to restrict efforts to "condition[ ] the market." *See* Stephen J. Choi and A.C. Pritchard, *Essentials of Securities Regulation* 315 (2008) (explaining that "[i]nvestors are not islands" and "as a group may . . . feed[ ] off the excitement of other investors and mak[e] poor investment decisions"). It also protects investors, including the elderly, from fraud and abuse in highly risky, illiquid offerings. *See, e.g.*, Jason Zweig, *Want to Buy a Private Stock?*, Wall St. J., Sept. 7, 2012, http://www.wsj.com/articles/SB10000872396390443589304577637790108826970 (describing the view that the investors protected by the general solicitation prohibition include elderly persons who meet the financial threshold for investing but who are "especially prone to having their money pried out of them by . . . promotions"). Violating Section 5 and Rule 506 undermines the investor protection purposes of those provisions.

KCD also incorrectly argues that the NAC should not have applied the 2015 edition of the Guidelines ("2015 Guidelines"), which raised the high end of the fine ranges by indexing

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[29] *Notice of Adoption of Rule 146*, Securities Act Release No. 5487, 1974 SEC LEXIS 3297, at *10 (Apr. 23, 1974) (explaining that "the Commission believes that there must be limitations on the manner of offering securities . . . to assure that persons to whom such securities are offered have the necessary information available concerning the issuer and can fend for themselves" and "[t]o assure the non-public manner of the offering").

them to the Consumer Price Index,[30] because it was adopted after the parties briefed the issues before the Hearing Panel. Br. 27. Just as the preceding edition of the Guidelines did, the 2015 Guidelines "supersede prior editions," "are effective as of the date of publication, and apply to all disciplinary matters, including pending matters." *Guidelines*, at 8 (2015); *Guidelines*, at 8 (2011); *see, e.g., Dep't of Enforcement v. Rooney*, Complaint No. 2009019042402, 2015 FINRA Discip. LEXIS 19, at *102 n.53 (FINRA NAC July 23, 2015) (rejecting respondent's argument that the Hearing Panel erred by applying the most recent version of the Guidelines that existed at the time of the Hearing Panel's decision). Although KCD asserts that the particular problem was that the 2015 Guidelines became effective after briefing before the FINRA Hearing Panel was completed, KCD was able to make its argument to both the Hearing Panel and the NAC that its fine should either be zero or $2,500. RP 3429, 3614, 3742. Moreover, the NAC imposed a single fine for *both* of KCD's violations—its sales of unregistered securities *and* its supervisory violations—in an amount that is supported under either the 2015 version of the Guidelines or the prior version.[31]

Finally, KCD argues that the sanctions cannot be reconciled with the Commission staff's August 2014 decision not to recommend enforcement action against Westmount Realty Capital, and that the NAC erred in denying KCD's request to admit that decision, and other materials concerning the Commission staff's investigation, as additional evidence. Br. 13, 31. The NAC,

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30 *FINRA Regulatory Notice 15-15*, 2015 FINRA LEXIS 19, at *7 (May 2015). The 2015 Guidelines resulted from a review "to determine whether the sanctions imposed in FINRA's disciplinary proceedings are sufficient to achieve deterrence and reflect sanction trends in litigated and settled cases." *Id.* at *3.

31 *See Guidelines*, at 24, 105 (2011) (guidelines for sales of unregistered securities and failures to supervise, each of which recommend fines ranging up to $50,000).

however, properly denied KCD's motion because that evidence is not material. *See* FINRA Rule 9346(b) (requiring a showing of materiality). The investigation on which KCD relies was conducted by a different regulator, the SEC, and examined a different party, the issuer. The staff's decision was expressly provided under guidelines that it "must in no way be construed as indicating that the party has been exonerated or that no action may ultimately result from the staff's investigation of that particular matter." *See* RP 3783 (citing *Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations*, Securities Act Release No. 5310, 1972 SEC LEXIS 238, at *7 (Sept. 27, 1972)). The most that the August 2014 letter could mean is that "as of its date, the staff of the Commission does not regard enforcement action as called for based upon whatever information it then has," which "may be based upon various reasons, some of which, such as workload considerations, are clearly irrelevant to the merits of any subsequent action." 1972 SEC LEXIS 239, at *7-8. Thus, even if Commission staff investigated any of the same issues in the instant appeal (including issues concerning the general solicitation of the WRF Fund), its decision not to recommend enforcement action provides no relevant information concerning whether KCD violated FINRA rules.

Considering that substantial aggravating factors outweighed the minor mitigating factors, a censure and a $73,000 fine are appropriate to deter KCD and others from engaging in sales of unregistered securities and failing to supervise sales of unregistered securities. The sanctions, which are neither excessive nor oppressive, should be sustained.[32]

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[32] Although the Guidelines also recommend disgorgement, the record does not contain evidence of the fees KCD actually earned. Instead, the evidence only demonstrates that KCD's "up to 5%" fee could have exceeded $100,000.

## V. CONCLUSION

The record supports the NAC's findings that KCD sold unregistered securities in contravention of Section 5 of the Securities Act and in violation of FINRA Rule 2010, and that KCD failed to supervise those sales, in violation of NASD Rule 3010 and FINRA Rule 2010. The sanctions imposed will deter KCD from engaging in similar misconduct in the future and protect investors. The Commission should affirm the NAC's decision in all respects.

Respectfully submitted,

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Dated: November 21, 2016

**ATTACHMENT A**

FINRA

Financial Industry Regulatory Authority

# Sanction Guidelines

# Table of Contents

# Unregistered Securities—Sales of

**FINRA Rule 2010 and Section 5 of the Securities Act of 1933**

| Principal Considerations in Determining Sanctions | Monetary Sanction | Suspension, Bar or Other Sanctions |
|---|---|---|
| ***See Principal Considerations in Introductory Section*** | Fine of $2,500 to $73,000.[1] | ***Individual*** |
| 1. Whether the respondent attempted to comply with an exemption from registration. | In egregious cases, consider a higher fine. | In egregious cases, consider a lengthier suspension in any or all capacities for up to two years or a bar. |
| 2. Whether the respondent sold before effective date of registration statement. | | ***Firm*** |
| 3. Share volume and dollar amount of transactions involved. | | In egregious cases, consider suspending the firm with respect to any or all activities or functions for up to 30 business days or until procedural deficiencies are remedied. |
| 4. Whether the respondent had implemented reasonable procedures to ensure that it did not participate in an unregistered distribution. | | |
| 5. Whether the respondent disregarded "red flags" suggesting the presence of unregistered distribution. | | |

1. As set forth in General Principle No. 6, Adjudicators may also order disgorgement.

# Supervision—Failure to Supervise

**FINRA Rule 2010 and NASD Rule 3010[1]**

| Principal Considerations in Determining Sanctions | Monetary Sanction | Suspension, Bar or Other Sanctions |
|---|---|---|
| ***See Principal Considerations in Introductory Section***<br><br>1. Whether respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny. Consider whether individuals responsible for underlying misconduct attempted to conceal misconduct from respondent.<br>2. Nature, extent, size and character of the underlying misconduct.<br>3. Quality and degree of supervisor's implementation of the firm's supervisory procedures and controls. | Fine of $5,000 to $73,000.[2]<br><br>Consider independent (rather than joint and several) monetary sanctions for firm and responsible individual(s). Consider suspending responsible individual in all supervisory capacities for up to 30 business days. Consider limiting activities of appropriate branch office or department for up to 30 business days. | In egregious cases, consider limiting activities of the branch office or department for a longer period or suspending the firm with respect to any or all activities or functions for up to 30 business days. Also consider suspending the responsible individual in any or all capacities for up to two years or barring the responsible individual. In a case against a member firm involving systemic supervision failures, consider a longer suspension of the firm with respect to any or all activities or functions (of up to two years) or expulsion of the firm. |

1. This guideline also is appropriate for violations of MSRB Rule G-27.
2. As set forth in General Principle No. 6, Adjudicators may also order disgorgement.

## CERTIFICATE OF COMPLIANCE

I, Michael J. Garawski, certify that the foregoing FINRA's Brief in Opposition to Application for Review (File No. 3-17512) complies with the length limitation set forth in SEC Rule of Practice 450(c). I have relied on the word count feature of Microsoft Word in verifying that this brief contains 13,100 words.

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## CERTIFICATE OF SERVICE

I, Michael J. Garawski, certify that on this 21st day of November 2016, I caused a copy of the foregoing FINRA's Brief in Opposition to Application for Review (File No. 3-17512) to be sent via overnight delivery to:

Jill G. Fieldstein, Esq.
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and the original and three copies to be hand-delivered to:

Brent Fields, Secretary
Securities and Exchange Commission
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Washington, D.C. 20549-1090

Service was made on the Commission by messenger and on the Applicant's counsel by overnight delivery service due to the distance between the offices of FINRA and Applicant's counsel.

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