UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 84795/ December 11, 2018

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In the Matter of the Application of WILLIAM H. MURPHY & CO., INC. and WILLIAM H. MURPHY For Review of Disciplinary Action Taken by FINRA	**OPENING BRIEF**

January 10, 2019

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STATEMENT REGARDING ORAL ARGUMENT

William H. Murphy & Co., Inc. ("WHM") and William H. Murphy ("Murphy") request oral argument. This disciplinary proceeding involves many complex issues that can easily become convoluted and confusing and oral argument may assist the Securities and Exchange Commission ("SEC") with the numerous issues involved herein and help clarify questions or concerns.

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STATEMENT OF APPEAL

The decisions ("Decisions") rendered by the Extended Hearing Panel ("Panel") and the National Adjudicatory Council ("NAC") arbitrarily applied securities laws and regulations to this case and found facts that are unsubstantiated by, and contrary to, uncontested record evidence. The Decisions are arbitrary and capricious. Respondents respectfully request reversal and dismissal of the Decisions.

PROCEDURAL HISTORY

The Panel sanctioned Respondents $228,210.91 for violating FINRA Rules 2010 and 3010 by engaging in unregistered securities sales without an available exemption. The NAC upheld the Panel Decision but reduced the sanctions to $139,118.53. Respondents timely appeal the NAC Decision.

FACTS

I. GENERAL

This is a case of first impression. WHM implemented many measures to protect investors and avoid a 502(c) violation. There is no dispute that (1) a substantive relationship between WHM and a client before a client was introduced to private placement information or an issuer; (2) a sufficient cooling off period existed; (3) generic public advertising and communications; (4) limited access to private offering materials to only qualified and suitable investors; and (5) all investors were well informed and sophisticated. WHM surpassed what was permitted in previous no-action letters to protect investors and it worked. All investors are satisfied with their investment, were fully informed and profited from the investment. There are no damages in this case. Yet, the Decisions found a 502(c) violation despite acknowledging the protective measures WHM put in place.

II. THE PARTIES

A. WHM AND MURPHY

William H. Murphy ("Murphy") entered the securities industry in 1968. William H. Murphy & Co., Inc. ("WHM") became a registered broker-dealer in 1990 and had 19 non-registered locations, 25 registered representatives and two offices of supervisory jurisdiction. WHM and Murphy have a history of compliance oriented behavior and no disciplinary history. WHM and Murphy terminated their FINRA membership in 2018.

B. LREA

Liberty Real Estate Advisors, L.L.C., ("LREA") was a startup business that provided educational and networking opportunities to people interested in real estate.[1] Except for the referral business arrangement, LREA was not affiliated with WHM and Murphy.[2] LREA's primary purpose was to provide the public with real estate related education.[3] This education covered a full range of real estate related topics including, but not limited to, wholesale property, flipping properties, landlord responsibilities, selling real estate, financing, single and multi-family investing, management and marketing, performing due diligence, Fair Housing basics and discrimination, single family homes, rehabilitating properties, understanding financial statements, general market data and trends.[4] LREA advertised services online and by radio. Interested listeners signed up for educational workshops taught by LREA employees and/or guest speakers; webinars; property tours; case studies on past real estate transactions; and social

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[1] RP 7598:3-5; 10478 ¶3.2.1; 10454, Art. 2(B) and (C).
[2] RP 10453.
[3] RP 10453, ¶3. 10454, Art. 2.; 10478, ¶3.2.2.; 10479, ¶3.3.3, 10869.
[4] RP 10892, 10890-91, 10883-10888, 10889, 10909-23, 10897; 6667:7-16, 6109:13-20, 6410:24-6411:9, 6132:16-20, 7891:2-13.

functions that include keynote speakers.[5] LREA offered free classes to gain gravitas and eventually sell its educational and networking services.[6]

LREA's secondary purpose was to be a real estate social and networking forum dedicated to developing a community of individuals involved in real estate to facilitate the cooperation between real-estate interested persons such as contractors, property managers, real estate advisors, title companies, real estate agents, real estate related vendors, investors and anyone interested in the real estate industry.[7] People in the network who decided to invest with others rather than buy their own properties had an opportunity to meet with a licensed broker, in this case WHM.

C. ISSUERS

The Issuers were Texas limited liability companies that issued exempt securities.[8] The Issuers generally purchased distressed multi-family properties, rehabilitate, rent, operate and later sell for profit.[9] No Issuer employed a WHM registered representative. WHM never employed anyone from an Issuer. WHM and the Issuers are no longer doing business together. Some Issuers were indirectly affiliated with LREA. For example, Trey Stone is affiliated with the Issuers by being a member and with LREA, by being its president. The Issuers are distinct separate legal entities from WHM and LREA.

III. THE REFERRAL ARRANGEMENT

WHM ensured that the referral arrangement between WHM, LREA and the Issuers, complied with securities laws and regulations by implementing extensive procedures to protect

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[5] RP 10459, 6651:13-17, 6700:9-15, 6283:22-24, 6284:3-6,
[6] RP 10459-10463, 6448:21-22, 6449:21-6450:1, 6451:1-3, 6451:16-20, 6432:5-7.
[7] *Id.*
[8] RP 13631, 10529-34, 10547-553, 10389, 10417, 10439.
[9] RP 10564, ¶2.

new clients.[10] WHM supervised the Issuers and LREA's business practices to ensure no 502(c) violation.[11] Except for the referral arrangement and monitoring of third party and public communications, WHM was not affiliated with LREA or the Issuers. WHM was the gatekeeper to the public at virtually every step of this referral arrangement.

A. THE REFERRAL AND A SUBSTANTIVE RELATIONSHIP

LREA publicly advertised its educational and networking services through radio shows, advertisements and other public solicitations using generic non-specific content.[12] The Decisions acknowledge that LREA's public communications never specifically mentioned any issuer or a private placement offering[13]

If an LREA attendee sought investment opportunities instead of education, LREA referred him/her to WHM who conducted a "one on one" meeting.[14] WHM prohibited LREA employees from divulging any issuer or private offering information to any LREA student.[15] Instead LREA referred the student to a WHM representative.[16] During the "one-on-one", the referral could fill out a WHM New Account Form and a WHM Client Application Form and the WHM registered representative may discuss that new potential client's financial questions,

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[10] RP 10453-10458, 10465-10491, 6634:8-14, 6635:19-25, 6636:1-2, 6636:3-9, 6635:1-13, 6759:1-15, 7163:1-6, 6637:20-6638:25, 6961:6-13, 6636:18-6638:3, 6633:3-6634:1, 6637:1-6638:3, 6195:12-16, 6943:18-23, 6644:1-22, 7161:16-7162:21, 6636:13, 6733:14-6734:19, 6932:1-921:18, 7165:3-20, 7346:15-18, 7365:2-5, 7924:17-20, 7929:1-14.
[11] RP 10453-58, 10465-10491, 10927, 10931, 10925-26, 10903, 10905-6, 10925, 10895, 10889, 10934, 10933, 10936, 10939. NAC Decision states WHM reviewed all LREA emails, monitored LREA customer relationships, approved all LREA public communications. RP 14827, ¶6.
[12] RP 7891:16-24.
[13] RP 13994-13995, 14831.
[14] RP 13981.
[15] RP 6089:2-25.
[16] RP 6175.

concerns and/or simply hold a question and answer meeting.[17] When properly filled out, as the Panel correctly found, the new account form established a substantive relationship with the applicant.[18]

B. THREE STEP QUALIFICATION AND SUITABILITY PROCESS

1. SUITABILITY AND FINANCIAL STATUS DETERMINATION

WHM's Client Application Form was a suitability questionnaire that, if completed, provided WHM enough information to conduct a suitability analysis for that applicant and thus establish a substantive relationship.[19] Upon completion of the Client Application Form, WHM began the three step qualification process. First, once the Client Application Form was completed, compliance officer, Mark Hutton ("MH"), conducted a suitability analysis and determined if the applicant was qualified as accredited or sophisticated.[20] If a referral was qualified and suitable, MH forwarded that client's information to Michael Schaps ("Schaps") at the LeGaye Law Firm.[21] Schaps is the Director of Regulatory Compliance for the Firm and functions as a NYSE and FINRA FINOP.[22] Schaps conducted a second suitability and qualification analysis.[23] If Schaps determined that the client was qualified and suitable, then Schaps forwarded the Client Application Form to Murphy, who conducted a third suitability and qualification analysis.[24] At any time during this three step approval process, if MH, Schaps or

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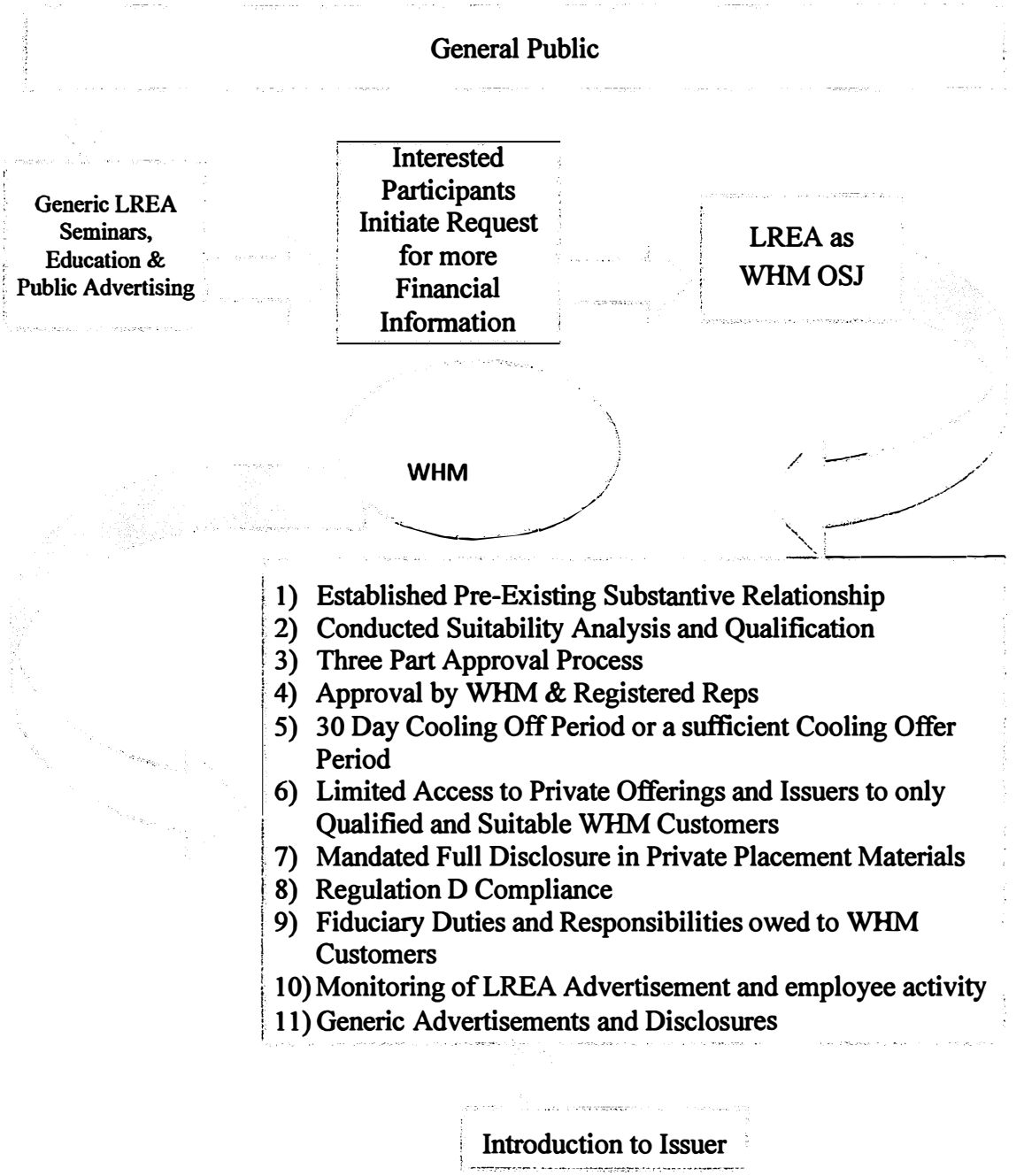
[17] RP 6081-6082, 6178-6181, 10478-10486, 6367:3-6.
[18] RP 13998.
[19] RP 13998.
[20] RP 7103:9-7108:9, 13229-62, 13263-65, 13267-76, 13277, 13297-13329, 13331-32, 13333-64, 13365-13370, 13371-13380, 11045, 11049, 11051, 11053.
[21] See Fn. 20.
[22] RP 11639.
[23] See Fn. 20.
[24] See Fn. 20.

Murphy needed more information from the client, they could consult each other, consult the client directly or the registered representative who held a one on one meeting.[25]

2. THE COOLING OFF PERIOD AND LIMITED ACCESS TO PRIVATE OFFERING INFORMATION TO ONLY THOSE QUALIFIED AND SUITABLE

After the **third** approval, The Decisions found that WHM required sufficient time elapse from establishing the substantive relationship and the day that the client could be introduced to the Issuers.[26] WHM introduced only those qualified/suitable clients to the Issuers. If WHM believed the Issuer's private offerings were not client suitable, then no introduction to that Issuer occurred.[27] Originally, the cooling off period was thirty days from the initial contact with the referred client through LREA. However, WHM implemented an additional 30 days starting from the day WHM established a substantive relationship with the referred client, implementing two cooling off periods.[28] In sum, this process is summarized in the following chart:

[25] See fn 20.
[26] RP 13998.
[27] See fn. 20.
[28] RP 11055.


General Public
Generic LREA Seminars, Education & Public Advertising
Interested Participants Initiate Request for more Financial Information
LREA as WHM OSJ
WHM
1) Established Pre-Existing Substantive Relationship
2) Conducted Suitability Analysis and Qualification
3) Three Part Approval Process
4) Approval by WHM & Registered Reps
5) 30 Day Cooling Off Period or a sufficient Cooling Offer Period
6) Limited Access to Private Offerings and Issuers to only Qualified and Suitable WHM Customers
7) Mandated Full Disclosure in Private Placement Materials
8) Regulation D Compliance
9) Fiduciary Duties and Responsibilities owed to WHM Customers
10) Monitoring of LREA Advertisement and employee activity
11) Generic Advertisements and Disclosures
Introduction to Issuer

C. THE REFERRAL ARRANGEMENT'S PRIMARY PURPOSE

The referral agreement grew out of two purposes. LREA's primary business purpose was to provide educational and networking opportunities to the general public and eventually profit by charging the public for access to this information.[29] WHM desired to expand its client base and the Issuers sought to expand their prospective private investor pool.

The second purpose was to ensure compliance with the laws and not issue or promote securities using public solicitation. All parties agreed to implement protective measures that break the chain of general solicitation so that that LREA's solicitations were not general solicitations in violation of 502(c). Those protective measures WHM implemented in the referral arrangement are illustrated above.

WHM placed itself between LREA's public solicitations communications and the Issuers thereby breaking the chain of solicitation. The Panel correctly found that LREA never used any public communications that referred or mentioned any Issuer private offerings.[30] WHM ensured this communication restriction by requiring all LREA solicitations and public communications be pre-proved by WHM.[31] WHM also instructed, and LREA agreed, that LREA implemented disclaimers on LREA public communications informing the public that LREA was not involved in selling or promoting securities.[32]

IV. LREA's BUSINESS PLAN CHANGED

Gary Blumberg ("Blumberg") and Trey Stone ("Stone") are in the real estate business. They saw a demand for real estate education. On February 24, 2010, Blumberg formed LREA,

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[29] RP 10478, §3.2.1.
[30] RP 13995, ¶3, 014831, ¶4.
[31] Fn. 20.
[32] RP10869.

funded by a loan from Stone.[33] LREA submitted an application to FINRA to become a broker dealer in 2010. In 2010, LREA disclosed to FINRA its two-fold business plan:

> "Liberty Real Estate Advisors, L.L.C. will be an Introducing Broker-Dealer in connection with real estate private placements and will provide education regarding the same. It will market its services, make suitability determinations for potential clients, build its clientele, provide basic information on private placements to its suitable clients, and introduce suitable clients to associated issuers involved in multifamily real estate private placements. In its activities, Liberty Real Estate Advisors, L.L.C. will not take possession or control of client funds or securities in connection with any private placement. Additionally, Liberty Real Estate Advisors, L.L.C. will provide workshops and other educational services to persons interested in real estate investment alternatives to the stock market."[34]

As a broker-dealer, LREA could introduce people who attended its workshops, and decided not to purchase and rehabilitate properties on their own, but invest, to issuers.[35] LREA applied for a Broker Dealer license and FINRA registration.[36] LREA submitted many documents to FINRA, including its business plan, ("JX-5")[37] and an example of a script for a proposed workshop, ("JX-67").[38] LREA's business plan, as a broker-dealer, outlined building a client base through "networking... talk radio, print advertisements..."[39] During the broker dealer application review in 2010, FINRA never questioned LREA's broker-dealer goals, its educational plan or its structure.[40] However, FINRA could not approve the broker-dealer application because, and ***only*** because, LREA did not have sufficient private offering experience.[41]

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[33] RP 6338:25-6339:5, 7593:9-22, 11990, ¶3.2.
[34] RP 11986.
[35] RP 11986, 11992.
[36] RP 6054:8-15.
[37] RP 11983-12016.
[38] RP 6130:15-6131:13, 6137:21-25.
[39] RP 11988.
[40] RP 7595:3-19.
[41] RP 7591-007593, 6073:6-15.

After receiving the FINRA's comments, LREA contacted FINRA specialist attorney, Dan LeGaye, ("LeGaye").[42] LeGaye advised that instead of hiring a person with more experience, LREA should withdraw its FINRA application and work with an established broker-dealer.[43] LeGaye introduced LREA to WHM.[44]

LREA withdrew its broker-dealer application and changed its business model, goals and objectives. WHM became the introducing broker to the Issuers and managed LREA public communications.[45] No longer seeking broker-dealer status, LREA reconfigured its business plan to focus solely on real estate education,[46] build a reputation, and eventually charge for its services similar to compete with Houston's premier real estate education company, Lifestyles.[47] Seven witnesses provided uncontroverted testimony that LREA's primary purpose was educational and a secondary purpose referring prospective clients to WHM.[48] In fact, Blumberg was not interested in education and resigned as LREA's CEO.[49] Stone became CEO/President in 2011.[50]

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[42] RP 7601:6-19.
[43] RP 7917:15-7919:25.
[44] RP 7921:2-9.
[45] RP 6089:17-25, 6404:1-4, 6469:20-23, 6829, 6893, 6930. The NAC Decision argues WHM contested his seller status for purposes of avoiding liability. This is a misunderstanding. WHM explained the distinct roles between LREA, WHM and the Issuers in the referral arrangement whereas WHM never sold securities, but WHM introduced clients to Issuers, i.e., WHM was an introducing broker. Because WHM is involved in the chain of sale, WHM can still be liable.
[46] RP 6182:22-6183:6; 6092-6100, 6535:7-15, 6135:11-14; 6117:14-23, 6081:1-2, 6060:16-23.
[47] RP 10459, 7604: 4-21, 6138:3-7, 6322:17-23, 6323: 17-20; 6779:4-19, 6808:1-8, 7604: 4-21, 7643:12-25, 7645:4-7650:3, 6099:8-6101:8 6338:25-6339:5, 7593:9-22, 11990, 12010-12015, 6808:1-8, 6806:21-25, 7645:4-7650:3, 6099:8-6101:8.
[48] RP 6779:4-24, 6182:22-6183:6, 6808:1-8, 7611:19-7612:20, 7643:12-25, 6135, 6117, 6095-6100, 6081, 9669, 6060.
[49] RP 7611:19-7612:20.
[50] RP 7613:13-23. 6069.

Ignoring LREA's revised business plan, the Decisions made determinations by using LREA's broker/dealer application, documents and business plan even though the application, documents and business plan were withdrawn and never actually used.[51] When the business model changed to education only, the transcripts of the public communications changed, the business plan and motives changed, everything changed.[52] Any "sales pitch" language from the application broker-dealer draft scripts was never approved or used.[53] Yet, the Decisions rely on references from the unused broker-dealer application draft scripts and documents to support their findings despite the uncontroverted evidence that the drafts were never used.[54]

V. WHM SUPERVISION

To ensure that there was no general solicitation violation, WHM placed an OSJ at LREA's office and placed Mindy Price ("Price") and Mark Hutton ("MH") in the office to work in a dual capacity.[55] They were employees of LREA on the real estate education side, and independent contractors registered representatives with WHM through the OSJ.[56] WHM's extensive supervisory control procedures governed LREA employees and WHM registered reps.[57] WHM pre-approved all LREA public communications, required LREA employees follow specific guidelines to ensure separation between LREA's educational functions and WHM's functions. LREA implement disclaimers in all public communications and many other protective

[51] RP 6137:7-6138:24. 13976.
[52] RP 6130:15-6131:13, 6137:21-25, 6140:21-1644:1, 6089:5-25.
[53] RP 6140:21-6142:22, 6146:1-23; 6155:11-6156:12, 6130:15-6131:13, 6137:21-25, 6076:8-13.
[54] RP 14005.
[55] RP 865-862.
[56] RP 13981, 856-867, 13637-13766.
[57] RP 10453-10454.

measures to ensure compliance with FINRA rules and regulations.[58] WHM had written supervisory procedures, training sessions, hands on monitoring, written instructions and many other procedures, all of which were reasonably designed to ensure compliance with the securities laws.[59]

ARGUMENT AND AUTHORITIES

I. THE DECISIONS ARE ARBITRARY, CAPRICIOUS AND NOT IN ACCORDANCE WITH THE LAW.

An agency's decision will be set aside if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[60] An action is arbitrary if the Panel fails to apply the appropriate standard.[61] The Decisions found that WHM sold unregistered, non-exempt securities in violation of Rule 502(c) by determining that the radio shows and workshops were "offers" of securities.[62] The Decisions failed to apply the appropriate standard when analyzing the facts of this case. Instead the Decisions arbitrarily applied SEC no-action letters to support their finding while arbitrarily rejecting SEC no-action letters and all legal argument that support WHM's position.

A. EXEMPT SECURITIES AND GENERAL SOLICITATION

Absent an exemption, §5(a) and (c) of the Securities Act make it unlawful for any person to, directly or indirectly, use interstate commerce to offer or sell any security unless a registration

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[58] RP 10869, 7645:4-13, 866-867, 6644:1-22, 7161:16-7162:21, 6636:13, 10491, 10931, 10991, 11021-22, 10867.
[59] RP 6637:20-6638:25, 10453-10454, 10491, 6633:3-12; 6636:18-6638:3, 6195:12-16.
[60] 5 U.S.C. §706(2)(A); *Mathis v. S.E.C.*, 671 F.3d 210, 215–16 (2d Cir.2012); *McCarthy v. S.E.C.*, 406 F.3d 179, 188 (2d Cir.2005) ("An appeals court reviews the SEC's affirmance of ... sanctions for abuse of discretion, and will only overturn sanctions if they are unwarranted in law or without justification in fact.").
[61] *WHX Corp. v. SEC*, 362 F.3d 854, 859 (D.C. Cir. 2004).
[62] RP 13965.

statement is filed or in effect with the SEC.[63] Exempt securities cannot involve a general solicitation in violation of Rule 502(c). Securities Act Rule 502(c) defines a "general solicitation or general advertising" to include "any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio" and "[a]ny seminar or meeting whose attendees have been invited by any general solicitation or general advertising."[64]

Importantly, the NAC Decision correctly states, "[n]ot all public communications... are general solicitations."[65] The SEC has taken the position that if there exists a "preexisting substantive relationship" between the offeree and the issuer or its agent, then an offer of securities to these offerees will not constitute a general solicitation.[66] But, the NAC Decision fails to discuss how there are other factors that determine whether there is a general solicitation violation. Some of those critical factors include a cooling off period, a pre-existing substantive relationship, limited access to private offering information to only those qualified and suitable, generic public communications, etc.[67] Any one or combination of such factors can avoid a 502(c) violation. In this case, WHM implemented all of those factors.

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[63] 15 U.S.C. §77e(a) and (c).
[64] 17 C.F.R. §230.502(c).
[65] RP 014832.
[66] *H.B. Shaine & Co. Inc.*, 1987 SEC No-Act. LEXIS 2004 (May 1, 1987).
[67] *Bateman Eichler*, 1985 SEC No-Act. LEXIS 2918 (Dec. 3, 1985); *IPONET*, 1996 SEC No-Act. LEXIS 642, *2 (July 26, 1996); *Lamp Technologies*, 1997 SEC No-Act. LEXIS 638, *6 (May 29, 1997); *H.B. Shaine & Co., Inc.* 1987 SEC No-Act LEXIS 2004 (May 1, 1987); *E.F. Hutton*, 1985 SEC No-Act. LEXIS 2917, *12-13 (Dec. 3, 1985); *Welton Street Investments, L.L.C.*, 2006 SEC No-Act. LEXIS 512 (June 27, 2006) ; *Chubb Securities Corp.*, 1993 No-Act. LEXIS 1402 (Nov. 24, 1993); *The Somerset Group, Inc.*, 1996 SEC No-Act. LEXIS 973 (Dec. 20, 1996); *Mid-Hudson Savings*, 1993 SEC No-Act. LEXIS 762 (May 28, 1993); *American Council of Life Insurance*, 2013 SEC No-Act. LEXIS 435 (March 28, 2013).

The main issue in this case is when the "offer" of securities occurred. The Decisions determine the "offers" were LREA's public advertisements and radio shows. WHM contends the "offers" were when WHM introduced a qualified and suitable client to an Issuer who then offered that client private offering information and materials.

B. PUBLIC ADVERTISEMENTS AND REFERRAL ARRANGEMENTS THAT DO NOT VIOLATE 502(C).

Networking and referral agreements have long been accepted as an established method of business in the private securities industry, so long as certain rules, factors or protective measures are in place, such as the ones discussed above and herein.[68] Generally, facts involving broker-dealers referral arrangements, generic public advertising, a cooling off period, a pre-existing substantive broker-dealer relationship, limited access to private placement information to only those qualified and suitable, and permitting only accredited and/or sophisticated investors to invest in the private offerings, is not 502(c) violation.[69] Broker-dealers in referral arrangements must maintain a system to supervise the activities of all parties involved in a private offering chain of sale, even issuer and non-issuer related third parties, like LREA and the Issuers in this

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[68] *Welton*, 2006 SEC No-Act. LEXIS 512 (June 27, 2006) (general solicitations were not in violation of §5); *Bateman,* 1985 SEC No-Act. LEXIS 2918 (Dec. 3, 1985) (SEC approved of a broker-dealer's networking agreement so that broker-dealer could expand its client base through public communications before offering private placements to new clients); *Shaine*, 1987 SEC No-Act. LEXIS 2004 (May 1, 1987) (A broker dealer's public advertisements and networking arrangement did not violate §5); *IPONET,* 1996 SEC No-Act. LEXIS 642 (July 26, 1996); and *Hutton.,* 1985 SEC No-Act, LEXIS 2917 (Dec. 3, 1985)(A broker dealer's public solicitations and networking did not violate §5); *Lamp,* 1997 SEC No-Act. LEXIS 638 (May 29, 1997) (unrestricted public solicitations were not in violation of §5); *Somerset*, 1996 SEC No-Act. LEXIS 973 (Dec. 20, 1996) (The networking arrangement did not violate §5); *Mid-Hudson*, 1993 SEC No-Act. LEXIS 762 (May 28, 1993) (The general solicitations did not violate §5); *American Council of Life Insurance*, 2013 SEC No-Act. LEXIS 435 (March 28, 2013) (Unregistered non-securities related entities can have networking arrangements with registered broker dealers by 'affiliation' or by 'association by contract'); *Chubb*, 1993 No-Act. LEXIS 1402 (Nov. 24, 1993).

[69] *Id.*

case.[70] WHM had to monitor all parties in the referral arrangement. A broker dealer can publicly solicit new clients.[71]

1. *Bateman Eichler*, SEC No Action Letter, Dec. 3, 1985

In 1985 the SEC permitted a broker-dealer to establish a referral program wherein it conducted seminars and speaking engagements for the purpose of soliciting new investors to expand its private offering client base.[72] After the seminars and speaking engagements, the broker established a pre-existing substantive relationship with the newly solicited clients by filling out questionnaires that, when satisfactorily completed, provided the broker with sufficient information to determine whether the client was qualified and suitable to invest in the private offerings.[73] Additionally, the broker instituted a cooling off period, "a minimum of 45 days after the initial mailing" before sending the qualified prospective investor private offering materials or information.[74] The broker's first contact with potential investors was through public advertisements and questionnaires wherein the public advertisements and questionnaires did not reference or discuss any specific private offering. The SEC determined the public advertisements were not "offers" in violation of 502(c) even though the purpose behind the advertisements was to solicit new clients for a private offering. Second, any subsequent private "offer(s)" would not violate Rule 502(c) because the broker used *generic* public advertisements, implemented a cooling off period and established a substantive relationship before providing the solicited prospective investors with private offering materials or information.[75] Notably, the SEC did not

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[70] *Id.*
[71] *Id.*
[72] *Bateman*, 1985 SEC No-Act. LEXIS *3-4.
[73] *Id.*
[74] *Id. at *5.*
[75] *Bateman*, 1985 SEC No-Act. LEXIS at *3-4.

determine the public advertisements "conditioned the market" any general solicitation violation even though the broker was publicly soliciting new prospective investors for private offerings.

2. *E.F. Hutton*, SEC No-Action Letter, Dec. 3, 1985

Like *Bateman*, *Hutton* approved a broker-dealer business model involving public solicitations for private offerings. In *Hutton*, a broker-dealer, who also acted as general partner and selling agent of unregistered real estate limited partnerships, could send "pre-offering materials" to prospective clients.[76] The "pre-offering materials" was a letter summarizing the material terms of the offering and described the real property to be purchased.[77] The purpose of the "pre-offering materials" was to determine a prospective client's interest in the offering prior to sending the full offering disclosure documents.[78] Before sending the full disclosure documents, the broker qualified potential investor by (1) information obtained through an existing business relationship or (2) information provided by a generic questionnaire provided the broker "with sufficient information to evaluate the prospective offeree's sophistication and financial circumstances such that" a later private offer would "appear to be appropriate in light of the suitability standards established by issuer and Rule 506."[79] *Hutton* explained that a pre-existing substantive business relationship with the solicited prospective investor could be established by a "satisfactory response" to the generic questionnaire.[80]

Hutton further noted that any relationship established through advertising or general solicitation must have "sufficient time" between the establishment of the relationship and the

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[76] *E.F. Hutton*, 1985 SEC No-Act. LEXIS 2917 (Dec. 3, 1985).
[77] *Id.* at *6-7.
[78] *Id.*
[79] *Hutton*, 1985 SEC No-Act. LEXIS at *9.
[80] *Id.*

actual offer in order "to safely extend an offer to make a private purchase."[81] Because the broker created a substantive relationship through questionnaires and required a cooling off period before the broker actually made the "offer," i.e., providing full disclosure materials, the SEC agreed that private offers could be made to people who were generally solicited without violating Rule 502(c). Importantly, the SEC determined that the original pre-offering materials were not "offers" or "conditioning the market" or "awakening an interest" even though the substantive relationship was established after a solicited investor received the "pre-offering materials." Here, the public advertisements "pre-offering materials" were not considered to be "conditioning the market" even though the actually mentioned and discussed information concerning an ongoing live offering.

3. *H.B. Shaine*, SEC No-Action Letter, May 31, 1987.

H.B. Shaine & Co., Inc. ("Shaine") also concerned a broker dealer who used public advertising and solicited new prospective investors for private offerings. Shaine sent a questionnaire to non-clients, to obtain the information necessary to establish a substantive relationship with prospective clients and later offer them private offerings.[82] The questionnaire sought information regarding the prospective clients' financial and educational sophistication.[83] The SEC determined that obtaining the information sought in the proposed questionnaire provided sufficient information to establish a pre-existing substantive relationship.[84] Again, the SEC required that "sufficient time" elapse between a potential client's completion of the

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[81] *Id.* *12-13.
[82] *H.B. Shaine,* 1987 SEC No-Act LEXIS 2004, (May 1, 1987).
[83] *Id.*
[84] *Id.*

questionnaire and the contemplation or inception of any particular offering.[85] Again, the SEC did not consider the original public advertisements that solicited prospective investors to be "offers" or "conditioning the market" in violation of 502(c).

4. *IPONET*, SEC No-Action Letter, July 26, 1996

In *IPONET*, like *Bateman*, *Hutton* and *Shaine*, a broker dealer wanted to expand its private investor base using a public advertisements. In *IPONET*, the broker wished to identify potential new clients via a webpage, IPONET.[86] IPONET publicly advertised the opportunity to purchase private and public securities after becoming a member of the IPONET webpage.[87] The unrestricted advertisements were generic and never mentioned any specific private placement. In IPONET, a broker supervised the activities of IPONET.[88] To register with IPONET, potential investors completed an online questionnaire that provided the broker with enough information to determine the prospective investor's qualification as accredited or sophisticated under Rules 506 and 501.[89] After completion of the questionnaire, the broker determined whether they were qualified as accredited or sophisticated and established a substantive relationship based off completion of the questionnaire.[90] A qualified client was then given a password to access the IPONET web pages that contained private offering information.[91]

Unlike the previous no-action letters, *IPONET* did not have a cooling off period. Instead, solicited new clients were prohibited from investing in any private offerings that were posted on

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[85] *Id.*
[86] *Id.*
[87] *IPONET*, 1996 SEC No-Act. LEXIS 642, *4-5 (July 26, 1996).
[88] *Id. at* *5.
[89] *Id. at* *9. 17 C.F.R. §230.501(e)(1)(iv)(excluding accredited investors from the calculation of number of purchasers under Rule 506(b); 17 C.F.R. §230.506(b)(2)(ii)(setting forth the knowledge and experience requirements for purchaser who are not accredited investors).
[90] *Id.*
[91] *Id.*

the website prior to the prospective offeree's qualification. Despite no cooling off period, the SEC found no 502(c) violation and the public advertisements were not "offers" of "conditioning the market."

5. *Lamp Technologies, Inc.*

Similar to *IPONET*, *Lamp* concerned a website designed to introduce prospective investors to private offerings.[92] *Lamp* changed the regulatory landscape and permitted generally solicited prospective investors to invest in live offerings, provided certain measures were implemented.[93] Lamp Technologies solicited prospective investors for private placements using unrestricted online advertisements. The website required new members to complete a generic questionnaire, that provided sufficient information to determine whether the prospective investor's qualification or accreditation. After the prospective investor was qualified, the investor waited 30 days before investing in any fund, some were made on a semi-continuous basis, i.e., were live when the investor was solicited.[94] *Lamp* differs from *IPONET* in that *IPONET* investors were only given access to investment opportunities that originated after the investor was qualified as a potential investor. In *Lamp*, once investors were qualified and became subscribers, they had access to investments that existed before they were qualified or sought subscription to the site. *Lamp* dealt with the "live offering" issue by requiring subscribers to agree that they would not invest in anything for 30 days after the subscriber's qualification.[95]

Based upon *Lamp*'s procedures to qualify investors and limit access to private offering material to only those qualified, the SEC determined there was no 502(c) violation. Importantly,

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[92] *Lamp*, 1997 SEC No-Act. LEXIS 638, *6 (May 29, 1997).
[93] *Id.*
[94] *Id. at* *2.
[95] *Id. at* *2.

Lamp found that the unrestricted public advertisements were not "offers" or "conditioning the market" even though they solicited new clients for the private placements. The important protective measures were s cooling off period, generic advertising and limited access to private placement information to only qualified investors.

6. There Are Many SEC-No Action Letters Which Find Public Solicitations Are Not In Violation of 502(c)

In *Welton Street Investments, L.L.C.*, the SEC found the public solicitations were not a §5 violation.[96] In *The Somerset Group, Inc.*, the SEC found the networking arrangement did not involve a §5 violation.[97] In *Mid-Hudson Savings*, the SEC found the public solicitations were not in violation of §5 even though they were used to recruit new clients.[98] In *American Council of Life Insurance*, the SEC found unregistered non-securities related entities can have networking arrangements with broker dealers by 'affiliation' without violating 502(c).[99] In *Chubb Securities Corp.*, the SEC found the networking arrangement would not violate §5.[100] The commonality in these no-action letters is that certain specific protective measures do not render a general solicitation violation even when unrestricted public advertisements eventually lead to a private offering. WHM implemented these protective measures discussed herein. Therefore, based on all of these SEC no-action letters, the Decisions should have found that the unrestricted generic LREA public advertisements were not "offers."

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[96] *Welton*, 2006 SEC No-Act. LEXIS 512 (June 27, 2006).
[97] *Somerset*, 1996 SEC No-Act. LEXIS 973 (Dec. 20, 1996).
[98] *Mid-Hudson*, 1993 SEC No-Act. LEXIS 762 (May 28, 1993).
[99] *American Council of Life Insurance*, 2013 SEC No-Act. LEXIS 435 (March 28, 2013).
[100] *Chubb*, the SEC 1993 No-Act. LEXIS 1402 (Nov. 24, 1993).

C. THE DECISIONS' ARBITRARY CONCLUSIONS

1. The Decisions Arbitrarily and Capriciously Determine None Of The Protective Measures WHM Implemented Affect The 502(c) General Solicitation Analysis.

The Decisions reject all of the protective measures WHM implemented to prevent a 502(c) violation and arbitrarily determine that none of them apply to the facts of the case. The NAC Decision states, "the SEC's no-action letters are no defense to WHM's liability."[101] The Decisions applied none of the no-action letters that support WHM's position, yet, use no-action letters that support the Decision's findings.

a. Generic Public Advertisements Analysis Is Not Applicable

If there is no "offer" of a security, there cannot be a general solicitation.[102] Question 256.33 of the SEC Compliance and Disclosure Interpretations ("CD&I"), states that "if a presentation by the issuer does not involve an offer of a security, then the requirements of Act are not implicated."[103] CD&I Question 256.24 states, "[i]nformation not involving an offer of securities may be disseminated widely without violating Rule 502(c))." *Bateman, IPONET, Lamp, Hutton,* and *Shaine* found that the public advertisements which solicited private investors

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[101] RP 14836.

[102] SEC Compliance and Disclosure Interpretations, Question 256.33, Securities Act Rules. Avail. at http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm. Question 256.24 (Information not involving an offer of securities may be disseminated widely without violating Rule 502(c)); *Bateman*, 1985 SEC No-Act LEXIS 2918 (a public solicitation is generic when it does not "not make reference to any specific investment currently offered or contemplated for offering." Generic solicitations do not constitute an "offer" to sell securities).

[103] CD&I Question 256.33.

did not violate 502(c) because the public advertisements were generic, meaning they did not mention or refer to a specific private placement.[104]

The Decisions found that no LREA public advertisements mentioned or referenced any private security, yet, determined that the public advertisements were "offers."[105] This is contrary to the clear guidelines established in the no-action letters and CD&Is mentioned herein.[106] If the Decisions applied these no-action letters and CD&Is then LREA's generic public communications should not have been found to be "offers" in violation of Rule 502(c). The only factor the Decisions relied on was that the LREA public advertisements "conditioned the market" and therefore they were "offers." Without explanation, the Decisions ignore all other protective measures that make the LREA public advertisements not 502(c) violations contrary to the guidelines set out in the no action letters detailed above.

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[104] *Bateman,* 1985 SEC No-Act. LEXIS 2918; *IPONET*, 1996 SEC No-Act. LEXIS 642; *Lamp*, 1997 SEC No-Act. LEXIS 638; *Shaine,* 1987 SEC No-Act LEXIS 2004; *Hutton*, 1985 SEC No-Act. LEXIS 2917.

[105] RP 14833, 13994-95, 13987. In this case, the Panel found that LREA's generic public communications "awakened an interest" in private placements and were general solicitations in violation of Rule 502(c).

[106] *Hutton*, 1985 SEC No-Act. LEXIS 2917. *Bateman*, 1985 SEC No-Act. LEXIS 2918 (Dec. 3, 1985) (no 502(c) violation because the public advertisements did not mention or refer to a specific private placement even though the advertisements solicited new clients for the purpose of recruiting new prospective private investors); *IPONET*, 1996 SEC No-Act. LEXIS 642, *2 (July 26, 1996) (IPONET's generic advertising and questionnaire together with limited access to private offering materials to only accredited or sophisticated investors, is not a 502(c) violation). *Lamp*, 1997 SEC No-Act. LEXIS 638, *6 (May 29, 1997) (generic advertising and questionnaire with limited access to private offering information and materials to only accredited or sophisticated investors, is not a general solicitation violation); *Shaine,* 1987 SEC No-Act LEXIS 2004 (May 1, 1987) (generic advertisements and questionnaires were not general solicitation violations because the public advertisements did not mention or refer to a specific private placement even though the advertisements solicited new clients for the purpose of recruiting prospective private investors).

b. Cooling Off Period Is Not Applicable

A substantial focus in this case concerned whether there was an adequate cooling off period. The Panel Decision found, "[b]efore WHM referred a customer to issuers; it satisfied a waiting or cooling-off period."[107] The Panel also found that a substantive relationship was established with WHM before prospective investors were introduced to private placement materials.[108] Without explanation, neither Decision applies the cooling off period to the 502(c) general solicitation analysis.[109] Worse, the Decisions provide no securities law or regulatory precedent wherein a sufficient cooling off period exists and a 502(c) violation occurred.[110]

Cooling off periods are relevant to a 502(c) analysis. *Bateman, E.F. Hutton, Shaine* and *Lamp* are prime examples how cooling off periods affects a 502(c) violation. A "general solicitation" violation may be avoided when there is a cooling off period.[111]

c. Pre-existing Substantive Relationship and Fiduciary Duty Is Not Applicable

Similarly, the Decisions do not recognize how WHM established a substantive relationship with the referred client before WHM introduced the referred clients to Issuers who provided the private offering materials or information.[112] The Panel found WHM's new account form contained sufficient information upon which WHM could establish a substantive

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[107] RP 13983.
[108] *Id.*
[109] RP 103965-01410, 14815-14850.
[110] *Id.*
[111] *Bateman*, 1985 SEC No-Act. LEXIS 2918 (Dec. 3, 1985) (no 502(c) violation with a 45 day cooling off period); *IPONET*, 1996 SEC No-Act. LEXIS 642 (July 26, 1996) (no cooling off period, yet no 502(c) violation); *Lamp*, 1997 SEC No-Act. LEXIS 638 (May 29, 1997) (no 502(c) violation with a 30 day cooling off period); *Shaine,* 1987 SEC No-Act LEXIS 2004 (May 1, 1987) (no 502(c) violation with "sufficient time" cooling off period); *Hutton*, 1985 SEC No-Act. LEXIS 2917 (Dec. 3, 1985) (no cooling off time required yet no 502(c) violation).
[112] RP 13983.

relationship.[113] It is undisputed WHM established a substantive relationship with each referred client. Yet, without explanation, the Decisions do not factor this finding into the 502(c) analysis. The Decisions ignore that WHM established a fiduciary relationship with a referred client and was legally obligated it to act in their best interest. These factors play a significant part in determining that no general solicitation violation exists. Again, the Decisions offer no securities precedent or authority wherein a broker establishes a substantive relationship with a referred client before introducing that client to private offering information and still a 502(c) violation exists.

d. Limited Access To Private Offering Information and Materials To Only Qualified and Suitable WHM Clients.

WHM implemented a referral arrangement that limited access to private placement materials and information to only qualified and suitable WHM clients. The Decisions do not address *Lamp* which approved a business referral arrangement that publicly solicited prospective investors online, but limited the solicited investors to private offering materials by denying them access to such materials until they were determined qualified and suitable.[114] Similarly, WHM ensured that no recruited client had access to any private offering materials or information until they were found qualified and suitable and a cooling off period expired.

Again, the Decisions ignore these facts that affect whether there was a 502(c) violation and provide no securities regulatory or legal precedent where a broker dealer established a substantive relationship with a client, implemented a cooling off period, limited access to private placement offerings to only those qualified and suitable and still a 502(c) violation exists. The

[113] RP 13998.
[114] *Lamp*, 1997 SEC No-Act. LEXIS at *16-17.

Decisions complete rejection of undisputed facts and lack of relevant precedent supporting their 502(c) determination makes the findings arbitrary and capricious.

2. The Decisions Arbitrarily and Capriciously Determined that the Radio Shows and Workshops Are "Offers" to Sell Securities

The Decisions found the LREA radio shows and educational workshops awakened an interest in investing in real estate and therefore the radio shows and workshops were "offers" to sell securities.[115] Their reasoning is based on *Gerstenfeld*, *Gearhart* and *Prendergast* SEC no-action letters which are materially distinguishable from the facts of this case.[116] Neither *Gerstenfeld*, *Gearhart* nor *Prendergast* involved any of the protective measures discussed herein, i.e., a cooling off period, pre-existing substantive relationship and a fiduciary relationship, limited access to private placement information to only those qualified and suitable or generic public advertisements.

For instance, *Gearhart* found that the broker's public advertisements concerning lithium articles were "offers" because the broker sent the articles to approximately 3,000 securities dealers before the registration statement was filed.[117] Direct testimony from the broker explained the primary purpose of the lithium articles was to solicit new investors.[118] *Gearhart*'s analysis focused on awakening a public interest prior to a registration statement filing through the use of very specific public advertisements, rampant fraud through the offering materials and material misrepresentations, investor loss and none of the protective measures that occurred in *Bateman*, *Shaine, Hutton, Lamp and IPONET*. *Gearhart*'s analysis had nothing to do with a private

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[115] RP 13995, 14831.
[116] RP 14836. *Gearhart & Otis*, Inc., 42 S.E.C. 1, (1964), *Brian Prendergast*, 55 S.E.C. 289 (2001), *Gerald F. Gerstenfeld*, 1985 SEC No-Act. LEXIS 2790 (Dec. 3, 1985).
[117] *Gearhart*, 42 S.E.C. at 57.
[118] *Gearhart*, 42 S.E.C. at 59.

offering and the protective measures that occurred in this case. Thus, *Gearheart*'s analysis is materially distinguishable to this case.

Prendergast is also materially distinguishable. *Prendergast* focused on material misrepresentations in the offering materials, rampant fraud by the broker and how the public advertisements were made for the ***only*** purpose of attracting investors.[119] *Prendergast* found the public advertisements were "offers" in violation of 502(c) because they awakened a ***specific*** interest in a ***specific*** type of hedge fund and like *Gearheart*, there was "no reason other than marketing considerations for Prendergast to hold the free seminars" to recruit investors for the specific investment.[120] Prendergast had direct evidence in a letter that explained the only purpose for the advertisements was to recruit investors.[121] *Prendergast*'s analysis had nothing to do with the protective measures like the ones in this case making its 502(c) analysis is inapplicable.

In *Gerstenfeld,* the syndicator sold private securities and sought to publicly advertise to solicit new investors for private securities.[122] The SEC found the primary purpose of the public advertisements was to solicit new investors for private placements.[123] Like *Prendergast* and *Gearhart*, *Gerstenfeld* focuses on the primary reason for the advertisements and found that the public advertisements violated 502(c) since the ***only*** purpose of the advertisements was to solicit investors. Notably, *Gerstenfeld* had no protective measures in place such as the ones WHM implemented in this case making the *Gerstenfeld* analysis distinguishable. *Gerstenfeld* is

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[119] *Prendergast*, 55 S.E.C. 289 (2001).
[120] *Prendergast*, 55 S.E.C. at 307-08.
[121] *Id.* at 308.
[122] *Gerstenfeld*, 1985 SEC No-Act. *1-2.
[123] *Id.*

completely distinguishable from this case because LREA and WHM never sold or issued securities, they were only in the chain of solicitation.[124]

Prendergast and *Gearhart* indicate that "awakening" an interest alone does not automatically mean public advertisements are "offers" in violation of 502(c). There must also be a finding support with direct evidence that the ***only*** purpose for the public advertisement is to recruit investors for ***a specific*** private offering. "Conditioning the market" applies to conditioning prospective investors to purchase **a specific** investment.[125] In *Gearhart*, there were the lithium advertisements which created an interest in a specific lithium deal, National Lithium.[126] In *Prendergast*, the broker was seeking to awaken an interest in the Prism Hedge Fund.[127] In this case, it is undisputed that LREA's advertisements were for networking and educational purposes.[128] The Decisions found that LREA's public advertisements did not mention or refer to any specific security.[129] Therefore, because LREA's advertisements were not made only for the purpose of soliciting new investors and the referral agreement had many protective measures, the facts of this case are completely distinguishable from *Gerstenfeld*, *Prendergast* and *Gearhart*.

Recently, in *KCD Fin. Inc.*, the SEC's 502(c) analysis of "conditioning the market" turned on the public communication's mention of a specific investment.[130] The SEC states, "...

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[124] See pgs. 6-11 herein.
[125] *Tenney v. Credit Suisse First Boston Corp., Inc.*, 05-3430-CV, 2006 WL 1423785, at *1 (2d Cir. May 19, 2006); *In re Jenny Craig Sec. Litig.*, 1992 WL 456819, at *3 (S.D. Cal. Dec. 19, 1992).
[126] *Gearhart.* 42 S.E.C. at *59.
[127] *Prendergast*, 55 S.E.C. at *308.
[128] LREA would still exist even if WHM received no referrals because LREA was going to be a profitable networking and educational entity.
[129] RP 13994-5.
[130] *KCD Fin. In.*, 2017 SEC LEXIS 986 (March 29, 2017), RP 14673.

articles published ... were designed to arouse public interest in the WRF Fund offering and therefore constituted offers."[131] In *KCD*, the articles were posted on the issuer's unrestricted website.[132] Unlike *Prendergast*, *Gearhart* and *Gerstenfeld*, KCD implemented some protective measures by ensuring sales were to qualified investors that the Firm had a prior relationship with.[133] However, KCD did not limit access to issuer information to only qualified prospective investors, there was no cooling off period, generic public communications or a substantive relationship before prospective investors were introduced to issuer information. *KCD* is substantially distinguishable from this case.

Even if some of LREA's public communications and workshops discussed the benefits of investing in a particular type of property like multifamily real estate, such communications contained no information beyond factual business information. CD&I 256.25 states "[f]actual business information generally does not include predictions, projections, forecasts or opinions with respect to valuation of a security, nor for a continuously offered fund would it include information about past performance of the fund," thus such factual business information is not a general solicitation in violation of Rule 502(c).[134] The Panel found that LREA's public communications did not reference any specific security,[135] including any predictions, past performance, forecasts or opinions. Based upon the plain language of the CD&I, *Tenney*, and *In re Jenny*, *supra* fn. 125, LREA's public advertisements and educational seminars and workshops did not "condition the market" in violation of Rule 502(c) because, at the most, they discuss general business information about real estate.

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[131] *Id.* at *21. RP 14679-80.
[132] *Id.* at 26. RP 14681.
[133] *Id.* at 22. RP 14680.
[134] CD&I 256.25.
[135] RP 13994.

In *Prendergast* and *Gearhart*, there was tangible direct evidence that clearly demonstrated the purpose of the public communications.[136] Both brokers admitted to the purpose of the public communications was solely for recruiting investors. In this case, there is no direct evidence showing LREA's only purpose was to solicit investors for a specific private offering.[137] In fact, there is substantial testimony from virtually all witnesses that LREA was an educational entity.[138]

3. The Decisions Reject All General Solicitation Exceptions And Statutory Safe Harbors without Justification or Explanation.

The Decisions reject WHM's arguments regarding any legal support or defense, including the safe harbor provisions in Rule 508, Rule 506 and §4(a)(2). The only explanation offered for rejecting these safe harbors is that the "issuers used general solicitations to sell unregistered securities" therefore the protections are not applicable.[139] Again, the Decisions arbitrarily reject all legal authority when it support's WHM's position.

There is an exception to 502(c)'s general solicitation ban under Rule 508 which generally states that any failure to comply with a Regulation D exemption may not destroy the issuer's exemption if the non-compliance is an "insignificant deviation from a term, condition or

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[136] *Gearhart*. 42 S.E.C. at *18 (The broker admitted he sent the lithium articles because he was doing a specific lithium deal). *Prendergast*, 55 S.E.C. at *295 (the broker's letter stated the purpose of the seminar was only to attract new investors to Prism, a specific investment).
[137] The Decisions rely on withdrawn evidence from LREA's broker-dealer application. It is uncontested that the documents from this withdrawn business model were never used (RP 6130:15-6131:13, 6137:21-25, 6076:8-13) and do not reflect the actual LREA business model or purpose.
[138] RP 6355-56; 6077-99, 7650-51, 7131-33, 6462, 6099, 6596, 7133-35, 6779:7-11, 6780-81, 6135, 6117, 6099, 6100, 6099, 6095-98, 6081, 6097:20-64, 6069, 6060.
[139] RP 13993-14001, 14836-38.

requirement of Regulation D."[140] Rule 508 also states that Rule 502(c) general solicitations are not insignificant, but "significant to the offering as a whole."[141]

There is another exception in the release accompanying Rule 508, "if an offering is structured so that only persons with whom the issuer and its agents have a prior relationship are solicited, the fact that one potential investor with whom there is no such prior relationship is called may not necessarily result in a general solicitation."[142] Therefore, even if one prospective investor had no pre-existing substantive relationship, that mistake or oversight should not result in a general solicitation violation and eradicate a private exemption.[143] In this case, it is undisputed that **all** of the investors had a pre-existing substantive relationship before having access to any private offering materials[144] Therefore, based on the Release accompanying Rule 508, any other deviation should be insignificant.

Similar to the Decisions misapplication of Rule 508 and its exceptions, the Decisions misapply both §4(a)(2) and the safe harbor protections under Rules 502(c) and 506(c) by simply concluding that, because there is general solicitation, there is no defense whatsoever.[145] The Decisions ignore a safe harbor protection clearly stated in Rule 502(c) that:

> "[a]ny seminar or meeting whose attendees have been invited by any general solicitation or general advertising ...in which the issuer has made a ***good faith and reasonable attempt to comply*** with the requirements of such form, ***shall not be deemed to constitute general solicitation or general advertising for purposes of this section***..."[146]

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[140] 17 C.F.R. §230.508.
[141] 17 C.F.R. §230.508(a)(2) (An issuer may not rely on the "insignificant deviation" relief in Rule 508 for violations of Rule 502(c)).
[142] SEC Release No. 33-6825, 54 FR 11369-01,*11370 (March 20, 1989).
[143] *Id.*
[144] RP 13998.
[145] RP 13993-14001.
[146] 17 C.F.R. §230.502(c), see also RP 13699.

Again without substantial justification or any explanation, the Decisions ignore this carve out protection for issuers and those acting on the issuer's behalf. There is no evidence that WHM made no good faith attempt to comply with Rule 502(c); there is overwhelming evidence to the contrary that WHM went to great expense and hired legal counsel to assist it in compliance with this exemption.[147]

Rule 506 only requires that there be "substantial compliance" with the statutory obligations.[148] Therefore, substantially compliance is the statutory obligations and even if a private exemption fails under Rules 506, Congress has created statutes that protect private issuers under many safe harbor statutes.[149] Federal statute states, "[a]ttempted compliance with any rule in Regulation D does not act as an exclusive election" - the issuer can also claim the availability of any other applicable exemption. For instance, an issuer's failure to satisfy all the terms and conditions of rule 506(b) shall not raise any presumption that the exemption provided by §4(a)(2) of the Act (15 U.S.C. 77d(2)) is not available."[150] Even if the private exemption fails, WHM and the issuers can rely on maintaining that exemption under §4(a)(2).

4. Arbitrary and Capricious Findings of Fact

An SEC's factual findings are valid only if they are supported by ***substantial*** evidence.[151] "Substantial evidence" is "more than a mere scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion."[152] Additionally, the SEC

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[147] RP 7174-75.
[148] 17 C.F.R. §230.506, §230.501 and §230.502.
[149] 17 C.F.R. §230.502(c).
[150] *Id.*; 17 C.F.R. §230.506(b).
[151] 15 U.S.C. §78y(a)(4); *VanCook v. SEC*, 653 F.3d 130, 137 (2d Cir. 2011); quoting *Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182 (1973).
[152] *Richardson v. Perales*, 402 U.S. 389, 401 (1971).

determined that the evidentiary burden is preponderance of the evidence.[153] Most of the fact conclusions made by the Panel are unsupported by or is contrary to the uncontested evidence presented in the record.

The Decisions make untrue statements. For instance, the NAC Decision states Price admitted she discussed private placements issuers.[154] Yet, her testimony is that "I never spoke of a specific investment ever."[155] She was never to discuss a private placement, so she never read any of the materials. This was one of the clear lines of separation between LREA roles and WHM roles. Additionally, the NAC Decisions states that WHM does not dispute that no pre-existing substantive relationship existed with any of the 23 investors at issue. This is another misstatement, WHM did not have a such relationship at the time of the radio show and initial workshop. However, WHM established a substantive relationship before introducing any private offering materials or information to a qualified and suitable client.[156] There are many other unsubstantiated facts, too many to mention in this Opening Brief.

i. LREA Was An Educational Entity That Referred Clients to WHM

The Decisions ignore the fact that LREA changed its business purpose from being a broker-dealer entity to an educational entity that desired to become a for-profit educational and networking business that referred prospective clients to WHM.[157] LREA's multiple purposes are materially important when applying *Gearhart*, *Gerstenfeld* and *Prendergast* as discussed above.

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[153] *In the Matter of Howard Brett Berger*, Exchange Act Rel. No. 55706, p. 10 (May 4, 2007); citing to *Harman & MacLean v. Huddleston*, 459 U.S. 375, 390 and n.30 (1983) (declining to depart from preponderance of the evidence standard).
[154] 14827, ¶ 4.
[155] RP 6089:5.
[156] RP 13983, ¶2, 13984, fn.165, 13989, ¶ 2, 13998, ¶ 1.
[157] RP 10459, 6182:22-6183:6, 6138:3-7, 6779:4-19, 6322:17-23, 6323:17-20, 6783:6-15; 6193:11-13, 7613:13-23, 010897, 010892, 010890-91, 010873.

ii. WHM Was An Introducing Broker, Not A Seller

The Decisions conclusion WHM sold securities is unsupported by evidence.[158] There is no evidence WHM "sold" securities. WHM was a referring broker, a common securities industry practice.[159] This distinction is material because the Decisions fail to recognize what actually happened in this case. Although, WHM could be liable for participation in the chain of solicitation, the Decisions must respect the distinct entities and their respective duties which are supported by evidence and not make inferences unsupported by evidence.

The Decisions found Price sold and private securities to WHM customers despite uncontroverted testimony that WHM never discussed or provided any LREA attendee or WHM client with private offering materials or information.[160] WHM and Hutton substantiated Price's testimony.[161] In fact, FINRA's investigator found no witnesses to support this finding.[162] Without explanation for disregarding Price and other witnesses' uncontroverted testimony, the Panel found Price sold unregistered securities.[163]

iii. WHM Had Reasonable Supervisory Procedures

The Decisions found WHM did not have reasonable written supervisory procedures ("WSP").[164] The Decisions discounted all of the supervisory procedures WHM implemented in order to ensure no general solicitation violation occurred.[165] The Decisions fail to recognize

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[158] RP 14822 ¶2; 14833, fn. 18; 13990 ¶3.
[159] RP 6089:17-25; 6469:20-23.
[160] *Id.*; RP 6846:4-7, 7207:16-25, 6187:25-6188:17, 6085:10-17.
[161] RP 6749:24--6750:6; 6846:4-11; 7207:9-7208:3.
[162] Aside from misconstruing the disclaimers and using the withdrawn documents from LREA's broker-dealer application.
[163] Fn. 158.
[164] RP 13988, 14007, 14848.
[165] RP 10465-10460, 10491, 6632:13-19, 6730:11-23, 6732:13-25, 6743:11-14, 6756:22-6757:14, 6761:12-6763:7, 6766:13-6767:8, 6798:4-24, 1301-1317, 3259, 3291, 3314-15,

WHM's hands on training, extensive monitoring, the WHM and LREA specific written procedures, the training sessions, fingerprinting requirement, monitored email accounts, the CRM system to monitor client relationships, requiring an onsite compliance officer at all LREA events, that all public communications must be pre-approved by WHM, hiring a FINRA legal expert, etc.[166]

Instead of recognizing the extensive reasonable supervisory procedures WHM had that implemented a "waiting or cooling off period"[167] the Decisions focus on the fact that WHM's WSPs do not specifically say verbatim a 30 day cooling off period.[168] However, there is no rule, mandate or other FINRA requirement that says the WSPs or supervisory compliance procedures must have rules/controls for every situation. It would be impossible for any broker dealer to do that. The WHM WSPs are hundreds of pages. There is no requirement that every nuance of a broker-dealer's business be specifically covered, only that broker dealers provide ***reasonable*** supervisory procedures.

Additionally, a broker-dealer would not put a 30 day mandate in the WSPs or elsewhere since the cooling off period is a fluid concept, not an actual set number of days.[169] As WHM has explained extensively in previous filings,[170] the SEC does not require a set number of days and has clearly stated that length of the cooling off period depends on the particular *investor* and

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8140, 8251, 855-908, 13637-13766, 10867, 10869, 10871, 10879, 10883, 10887, 10889, 10895, 10903, 10905, 10909, 10927, 10931, 10933, 10939.

[166] RP The NAC found WHM reviewed all LREA emails, monitored customer relationships, and approved all public communications. RP 14827, ¶ 6. RP 6634:8-14, 6634:15-17, 6636:3-9, 6635:1-13, 6635:19-25, 6636:1-2, 7163:1-6, 6633:3-12, 6636:18-6638:3, 10491, 10465-10493 6633:3-6634:1, 6636:18-25, 6637:1-6638:3, 6195:12-16, 6644:1-22, 7161:16-7162:21, 6636:13.

[167] RP 13983.

[168] *Id.*

[169] RP 6754.

[170] RP 887-890, 13685-86.

situation.[171] Arguably, if a broker-dealer were to put "30 days" in its WSPs it would be acting against established SEC precedent stating that no specific time frame is proper to apply across the board; rather, it could be 30, 45 or more days or no days depending on the *investor* and the *investment*.[172]

Further, WHM's cooling off period supervision requirements and details were included in LREA's WSPs only and not in WHM's WSP because such applied only to a very limited subset of WHM registered representatives.[173] Since the application was limited to the LREA OSJ, rather than put such in WHM's firm-wide WSPs, WHM chose to train LREA personnel in detail on the cooling off period. WHM held instructional meetings, Q&A sessions, hands on training and/or legal counsel guidance.[174] The registered principal in charge of WHM's OSJ was instructed on the applications and usage of the cooling off period, including the methods to determine the length of the time period, to enable him to properly supervise and review all accounts and registered representatives[175] In addition, the WHM chief compliance officer performed a final review on applicable accounts and, if needed, provided further discussion and instruction to the WHM OSJ registered principal to ensure proper procedures were followed.[176] These processes and procedures are clearly set forth in the LREA OSJ WSPs.[177]

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[171] *Id.*, see also, fn. 114.
[172] *Id.*
[173] RP 10478, ¶3.2.3.
[174] RP 10491, 10465-10490, 6079:15-22, 6633:3-6634:1, 6636:18-25, 6637:1-6638:3, 6195:12-16, 6961:6-13.
[175] *Id.* RP 6818:2-6819:8, 7790:20-7791:12.
[176] RP 7790:20-7791:12, 6829-30, 6917-18, 7816.
[177] RP 10465-10490.

iv. Superimposed misbehavior and wrongdoing when none was alleged.

The Decisions argue WHM attempted to mislead the Panel by failing to include "Amended" when labeling RX-55, the "Amended Joint Client Service Agreement."[178] However, RX-55 was provided to the DOE prior to the hearing. If anyone opens the exhibit, on the first page in 20 point font, the document clearly states, "Amended Joint Client Service Agreement."[179] Incredibly, the Panel assumed WHM was trying to mislead it.[180]

RX-55 clearly states, "the prior Agreement dated March 15, 2011 inaccurately described Sponsor's business and activities and this Amendment was necessary to revise this inaccuracy and delineate the true record as to its duties and responsibilities hereunder"[181] This inaccuracy in the original Joint Client Services Agreement is evidenced in LREA's Policies & Procedures Guide, which clearly establishes that LREA was an educational entity "formed to educate the public about real estate investing" and that it "entered into an Office of Supervisory Jurisdiction with..." WHM.[182] The Joint Client Services Agreement had to be revised to reflect the actual working relationship and agreement between the parties.[183] Not only does the Amended Joint Client Service Agreement work in tandem and comports with the actual relationship and behavior of the parties, there is testimony from seven witnesses that confirm LREA's status as an educational entity that referred students to WHM. Without alleging any wrongdoing or fraud in the Complaint, the DOE asked WHM "Did you create this document to mislead this Hearing

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[178] RP 13973.
[179] RP 10453.
[180] RP 13973.
[181] RP 10453, ¶6.
[182] RP 10497.
[183] RP 10454, Art. 2, B.

Panel?" WHM answered, "No."[184] WHM's counsel, Dan LeGaye, testified it was his mistake and that he tried to "fix it."[185] Transactional lawyers cannot allow inaccurate contracts to exist; i.e., the contracts should reflect the reality of the parties' agreement. Additionally, the PPMs provided to investors explain how LREA "focuses on educating persons about multi-family real estate investing."[186] The Decisions ignore the PPMs plain language and insert an unsubstantiated inference that LREA was selling securities based on the language of the original Joint Client Service Agreement.[187]

II. PROCEDURAL PROBLEMS

A. The Decisions Reject All WHM Argument Without Justification

The Decisions determined WHM's reliance on SEC no-action letters is "no defense to WHM's liability."[188] The Decisions determined WHM's reliance on counsel is no defense.[189] In order to establish a reliance upon counsel defense, a respondent must show that he made complete disclosure to counsel, sought advice on the legality of the intended conduct, received advice that the intended conduct was legal and relied in good faith on counsel's advice.[190] Both WHM and LeGaye testified to these conditions with uncontroverted testimony,[191] but the reliance on counsel defense was rejected.

The Decisions rejected WHM's defense regarding federally permitted safe harbors and issuer protections. They discount WHM's credibility despite his history of good conduct and no

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[184] RP 7394:1-17, 7396:14-7397:12.
[185] RP 7957:23-7960:2; 7963:10-7964:14.
[186] RP 12149, last paragraph, 8373, ¶1, 8976, ¶1, 8981, ¶3.
[187] RP 14820, ¶ 1-3.
[188] RP 14836, ¶2.
[189] RP 14841, ¶3.
[190] *In the Matter of Howard Brett Berger*, 2007 Exchange Act Rel. No. 55706, p. 16 (May 4, 2007); citing *Toni Valentino*, Exchange Act Rel. No. 49255 (Feb. 13, 2004).
[191] RP 7921-26; 7871:9-7872:17; 7881:24-7882:19.

disciplinary history despite being an industry member for over 45 years. The Decisions arbitrarily apply federal law when it benefits their position and deny WHM's ability to rely on supportive federal law.

B. The Panel's Lack of Expertise and Absence of Expert Testimony Renders the Decision Arbitrary

The Panel should have expert knowledge of the issues related to private placements exemptions, general solicitation, and broker dealer referral arrangements in private placement sales. FINRA is required to use professional hearing officers who are attorneys with appropriate experience and training.[192] Expert knowledge is important because the issues in this case involve complicated legal and regulatory analysis. However, no one on the Hearing Panel possessed the requisite expertise legal and regulatory expertise in this case.

Panelists, Nicholas A. Filing and Bardea C. Huppert are industry members who have passed some series exams, are not attorneys and do not have the requisite expertise or knowledge regarding the complex legal and regulatory general solicitation issues in this case. Maureen Delaney ("Delaney"), the Hearing Officer, is a lawyer. However, she was not qualified to interpret and apply the securities laws and regulations to the facts of this case. She has no experience in private placement exemptions or the applicable federal and state laws and regulations related thereto.

Delaney's lack of knowledge and experience with private securities exemptions was clear at the hearing. Delaney stated that the dates for a cooling off period were irrelevant,[193] and that "the Panel has to determine if the cooling off period is applicable..."[194] Delaney also said the Panel does not "care about ... the number of days between the new account form date and the

[192] SEC Rel. 34-37538, IV.B.3.
[193] RP 1480:13-15.
[194] RP 1480:1-2.

transaction date." [195] Every practitioner with requisite knowledge on general solicitations knows"cooling off periods" are important for maintaining registration exemptions.[196] Even the DOE had an exhibit outlining a cooling off period. [197] Delaney's statements indicate that she has no idea why or how a cooling off period is relevant and applies to a 502(c) analysis. Hence, the Panel's Decision did not apply WHM's cooling off period to the 502(c) analysis.

Worse, WHM was not permitted to present expert testimony.[198] Instead of permitting an expert to clarify the legal and regulatory standards, the Panel insisted they were experts and no expert witness was necessary, "[t]he Panel is the only legal expert in this proceeding."[199] Because there is no evidence of the legal and regulatory standards in this case and no one was qualified to apply the laws and regulations to the facts of this case, the Panel's opinions and conclusions are arbitrary.

C. Hearing Officer Abused Her Discretion

Delaney blatantly abused her discretion.[200] Delaney limited most of WHM's evidence supporting WHM's defense by concluding the evidence was not relevant. Delaney prevented WHM from questioning witnesses about relevant evidence, instructed WHM counsel on what questions to ask or actually prevented WHM from asking certain questions.

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[195] RP 1462:17-18.
[196] *Bateman*, 1985 SEC No-Act. LEXIS 2918 (a 45 day cooling off period avoids a general solicitation violation); *Lamp*, 1997 SEC No-Act. LEXIS 638 (30 days is sufficient time to avoid a general solicitation violation); *Hutton*, 1985 SEC No-Act. LEXIS 2917 (The SEC required there be "sufficient time" between the establishing a substantive relationship and the later offer so that the issuer may safely extend an offer without violating §5); *Shaine*, 1987 SEC No-Act. LEXIS 2004 (no general solicitation violation with "sufficient time"); *IPONET*, 1996 SEC No-Act. LEXIS 642 (sufficient time no general solicitation with "sufficient time").
[197] RP 10305.
[198] RP 585.
[199] RP 1452:23-24.
[200] *Tempo Shain Corp. v. Berteck*, 120 F.3d 16, 20 (2nd Cir. 1997).

The most egregious example of Delaney's abuse was during WHM's cross examination of Eric Beck ("Beck"), FINRA's lead investigator. Beck testified that his investigation concerned "the sections on general solicitation under Section 5 and supervisory exceptions...."[201] However, when WHM questioned Beck about that same investigation and Regulation D and supervisory procedures related to a general solicitation; the Panel determined his answers WHM sought were irrelevant and prohibited that line of questioning.[202] WHM asked whether "Murphy had adequate procedures in place to prevent the sale of nonexempt securities," Delaney preventing Beck from answering.[203] WHM sought Beck's understanding of adequate Regulation D supervisory procedures, the Panel prevented Beck's answer.[204] WHM's questioned Beck's expertise as a FINRA investigator and the results of his investigation on a Rule 506 exemption and §5 violations. The DOE objected on the grounds that his impressions were a legal conclusion or irrelevant[205] and Delaney sustained the DOE's objections and concluded that line of questioning was irrelevant.[206] Beck represented himself to be the Principal at the hearing with vast factual knowledge of the case and that WHM could question him regarding his evidentiary findings. However, Delaney prevented that line of questions too.

> "... I think I'm entitled to talk to him about what evidence there is to support certain claims that have been made because I haven't seen it yet, and I'm entitled to know and he's my only opportunity.
> HEARING OFFICER DELANEY: You know what? No. That line of questioning is not relevant..."[207]

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[201] RP 7417:8-12.
[202] RP 7546:2-7550:18.
[203] RP 7546:25-7547:5.
[204] *Id.*
[205] *Id.*
[206] *Id.*
[207] RP 7485:1-7490:17.

WHM was prevented from questioning Beck about his understanding and evidence he reviewed when he made the summary exhibit, CX-180 because Delaney determined that Beck's opinions and understanding of the issues and evidence was irrelevant.[208] Beck formed a hypothesis about his WHM examination, but WHM was not allowed to ask him about the basis of his hypothesis or the evidence he reviewed to support his hypothesis.[209] Delaney prevented WHM from questioning Beck about evidence that relates to the charges brought against WHM.[210] Delaney refused to allow WHM to ask questions regarding the Beck's work, the documents he uncovered or the people he interviewed (including LREA students and investors). Delaney determined, "[i]t really doesn't matter."[211] Delaney limited WHM questions regarding who violated the cooling off period and why because she determined it was irrelevant.[212] WHM was prevented from questioning Beck's investigation regarding whether there were any solicitations at the workshops.[213] WHM was prohibited from asking Beck about what evidence he found to support a Rule 3010A and 2010 violation.[214] WHM was not permitted to discuss how Beck determined what information was relevant during his investigation[215] or discuss Beck's notes and impressions during his investigation.[216] Beck's notes were not provided to WHM for inspection prior to the hearing. Yet, Beck "personally formed [his] own opinion" and supplied

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[208] RP 7476:5-7; 7485:2-7, 7446-7447, 7416.
[209] RP 7469:1-2; 7485.
[210] RP 7486:20-7488:5.
[211] RP 7490:3-12; 7507:1-3; 20-21.
[212] RP 7512:21-25, 7493:1-15.
[213] RP 7516:12-14.
[214] RP 7541:17-25, 7542:1-25, 7544:1-3; 7546:19-25, 7541:1-5.
[215] RP 7548:23-25, 7549:1-25.
[216] RP 1483:14-16. Beck's notes were not provided to WHM prior to the hearing.

that opinion to Enforcement.[217] The Panel ruled Beck could sit in throughout the entire hearing even though Beck was not a FINRA principal, but only an investigator.

Beck had intimate knowledge of the alleged violations and legal inferences that led to the original Complaint. WHM sought to find specific testimony from Beck which would unfold the process of the investigation and bring light to Beck's first impressions of the evidence he reviewed or explain why he relied on withdrawn and outdated documents from LREA's broker-dealer application. Contrary to the assertions in the Complaint concerning red flags, Beck testified that he "saw red flags ... that [he] thought needed to be investigated" but it turned out the "red flags were false positives."[218] FINRA's primary investigator did not find anything of significant concern, but WHM was not permitted to effectively cross examine Beck to truly understand what he found during his investigation or his concerns.

i. The Evidence Sought Was Relevant

FINRA Rule 9263(a), the admissibility of evidence rule states that "[t]he Hearing Officer shall receive relevant evidence, and may exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial."[219] The rule does not define "relevant" but Federal Rules of Evidence ("FRE") do. "Evidence is relevant if: **(a)** it has any tendency to make a fact more or less probable than it would be without the evidence; and **(b)** the fact is of consequence in determining the action."[220] Thus taking the FREs as a persuasive supplement to the FINRA rules is not inconsistent with FINRA's national/federal regulatory position. Turning to Delaney's rulings, it is disturbing, and even outrageous, to find that she determined testimony of the lead

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[217] RP 7479:4-22.
[218] RP 7448.
[219] RP 7469:14-16. Evidence: Admissibility at: http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3947.
[220] FRE 401.

investigator and FINRA's only witness to be irrelevant when WHM questioned him on the evidence he investigated and the summary evidence he created. In ruling such responses irrelevant, Delaney blocked the Panel from hearing testimony that would be helpful in finding whether there was a 502(c) violation. WHM posed questions could have enlightened the Panel and speak to WHM's liability or lack thereof, especially because Beck determined all the red flags were "false positives"[221] Such information could have changed the Panel's overall perception about WHM's business model, credibility and may have rendered a different ruling.

ii. Hearing Officer Actions Prejudicially Benefit the DOE

Delaney was not a neutral administrator. Most, if not all of her actions, benefited of the DOE and hindered WHM. WHM made more than 35 objections. Only two were sustained in WHM's favor.[222] The DOE made over 30 objections. Almost all of the objections were sustained, except for five.[223] Delaney sua sponte objected on the record mostly to the DOE's benefit or to interrupt, limit or stifle WHM's presentation of evidence. Delaney virtually never interrupted, limited or stifled the DOE's presentation of evidence or line of questioning. Delaney permitted several days of witness testimony by the DOE going over documents that were never executed, authenticated or used and other evidence that was simply not relevant to a §5 claim. For instance, the DOE spent hours going through the Issuer's private placement materials which was never alleged by FINRA to have any legal fault whatsoever and had no relevancy to the 502(c) violation in this case. Yet, when WHM began questioning the PPMs, Delaney limited its questioning.

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[221] RP 7448.
[222] RP 14525-29.
[223] RP 14525-29.

D. WHM'S Due Process Rights Were Violated

WHM was deprived of its right to an impartial, neutral and disinterested tribunal. The Exchange Act of 1934, (the "Exchange Act") and the U.S. Constitution require FINRA set "a fair procedure" for disciplining its members.[224] Courts have held that the FINRA procedures mandated by the Exchange Act require the substance of procedural due process and fairness.[225] Additionally, the Rule of Lenity requires that when construing an ambiguous statute, the interpretation should be in favor of the defendant.[226] However, almost all interpretations in this case, fact, legal and regulatory interpretations were found against WHM.

E. No Neutral FINRA Proceeding

FINRA's Department of Enforcement ("DOE") is virtually successful in every enforcement proceeding. FINRA disciplinary proceedings begin when the DOE starts investigating a member and/or sends a respondent a Letter of Acceptance, Waiver and Consent ("AWC"). The AWC set out claims the against the member if the member does not sign the AWC. In this case, the DOE began its investigation of WHM during the summer of 2013.[227] A few months later WHM received an AWC.[228] Most disciplinary proceedings resolve after receipt of an AWC or another type of settlement before a formal complaint is filed. Very few disputes move forward with a disciplinary hearing. For instance, in 2015, 1052 respondents signed an

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[224] 15 U.S.C. §78o-3(b)(8); U.S. Const. Amend. XIV.
[225] *Cody v. SEC*, 693 F.3d 351, 357 (1st Cir. 2012); *Busacca v. SEC*, 449 Fed. Appx. 886 (11th Cir. 2011).
[226] *Cleveland v. United States*, 531 U.S. 12, 25 (2000).
[227] RP 14431-32.
[228] RP 14436-39.

AWC.[229] In 2014, 947 respondents filed an AWC and in 2013, 986 respondents filed an AWC. However, only 78 complaints were filed in 2013, 119 complaints were filed in 2014 and 101 complaints were filed in 2015. Even though few disciplinary proceedings ensue, almost none of the disciplinary proceedings filed with formal complaints resolved in favor of a respondent. In fact, decades have passed without a single disciplinary proceeding finding in favor of a respondent.[230] In this case, WHM declined to agree to a §5 violation proposed in the AWC and proceeded with the disciplinary hearing. Similar to the systematic ruling against virtually all respondents, the Panel found against WHM. Similarly, there are virtually no NAC decisions that reverse a panel decision in favor of a respondent.

F. No Neutral Hearing Officer

Administrative Law Judges, ("ALJs"), are entitled to a presumption of impartiality. This presumption may be rebutted by "a history of ALJs ruling for the agency."[231] In this case, Delaney, systematically rules against respondents. WHM found more than seventy (70) decisions where Delaney was the Hearing Officer and only one of those cases did the Panel find that the DOE did not meet its burden of proof.[232] Based on Delaney's history of rulings against respondents, it is clear that Delaney is not neutral, but systematically rules against respondents.

G. Violation of 6th Amendment

Delaney's arbitrary rulings during witness examination violated the 6th Amendment's confrontation clause. Delaney effectively prohibited WHM from engaging in the protections of

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[229] RP 14443-48; a summary of all FINRA Enforcement Decisions in favor of Respondents from 1996-2016. Recently, FINRA had limited access to its database and no longer provides public access to FINRA and SEC Decisions prior to 2005.
[230] *Id.*
[231] *Rothenberg v. Daus*, 481 F. App'x 667, 676 (2d Cir. 2012).
[232] RP 14450-51, a summary of disciplinary decisions when Maureen Delaney was the Hearing Officer according to FINRA's online database.

cross examination by ruling its questions to adverse witnesses as "not relevant." Cross-examination jurisprudence has "remained immutable" and is well established in our nation's history. The US Supreme Court ruled that cross-examination is vital to a fair proceeding and is "even more important where the evidence consists of the testimony of individuals whose memory might be faulty or who, in fact, might be perjurers or persons motivated by malice, vindictiveness, intolerance, prejudice, or jealousy." Thus, these established protections have been formalized by way of confrontation in the 6th amendment, and apply not only in criminal cases, "but also in all types of cases where administrative and regulatory actions are under scrutiny." Thus, in civil, criminal, and even administrative proceedings, the accused shall enjoy the right to be confronted with the witnesses against him. However, in this case, WHM did not have this ability to fairly confront its accuser.

H. No Fair Notice

Fairness requires that the firm or individual have notice of the charged illegal conduct.[233] Even minimal sanctions can be excessive if the individual could not fairly understand that the conduct was illegal.[234] In this case, WHM is still unclear how the conduct was illegal or a violation of FINRA rules because, as discussed above, the Panel completely disregards the majority prevailing modern views regarding broker-dealer referral agreements in private placements like those found in *Bateman*, *IPONET*, *Lamp* and *E.F. Hutton, H.B. Shaine, Whelton,* etc. WHM had no way of knowing that the Decisions would completely disregard SEC guidance, modern securities laws and regulations. There was no way to predict that the broker-dealer referral agreement, which incorporates all of the protective measures WHM implemented, would

[233] *Upton v. SEC*, 75 F.3d 92 (2d Cir. 1996).
[234] *Id.*

not uphold under scrutiny since broker-dealer referral agreements with many less protective measures have repeatedly passed scrutiny under the SEC. Therefore, without this predictability, WHM did not have notice that the charged conduct was illegal or a violation of securities regulations.

I. Sanctions Are Penal, Not Remedial and are Excessive

The authority granted to the SEC and FINRA, is not allowed punish lawful behavior under the guise that "the punishment was to deter future behavior in attempt to protect the securities industry."[235] They are permitted to "appropriately discipline" members.[236] "Penalty" is "a form of punishment imposed by the government for unlawful or proscribed conduct, which goes beyond remedying the damage caused to the harmed parties by the defendant's action."[237] In *Johnson*, the court found that even a temporary suspension was a penalty.[238] Here, there is no evidence of any party being damaged or injured. Therefore, the sanctions in this case are penal because they go beyond remedying the damage caused by WHM's actions.

J. Undeniable Conflict of Interests Impair Neutrality

FINRA hearing officers have undeniable conflict of interests. This requirement of neutrality in adjudicative proceedings safeguards the two central concerns of procedural due process, the prevention of unjustified or mistaken deprivations and the promotion of participation and dialogue by affected individuals in the decision making process.[239] The neutrality requirement helps to guarantee that life, liberty, or property will not be taken on the basis of an

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[235] *Wright v. SEC & Exch. Comm'n.*, 112 F.2d 89, 94 (2nd Cir. 1940).
[236] 15 U.S.C. §78s(h)(3); *Fiero v. FINRA*, 660 F.3d 569 (2011).
[237] *Johnson v. SEC*, 87 F.3d 484, 488 (D.C. Cir. 1996).
[238] *Id.* at 488.
[239] *Marshall v. Jerrico, Inc.*, 446 U.S. 238, 242 (1980), citing, *Carey v. Piphus*, 435 U.S. 247, 259–262, 266–267 (1978).

erroneous or distorted conception of the facts or the law.[240] At the same time, it preserves both the appearance and reality of fairness, "generating the feeling, so important to a popular government, that justice has been done,"[241] by ensuring that no person will be deprived of his interests in the absence of a proceeding in which he may present his case with assurance that the arbiter is not predisposed to find against him.

FINRA is a not-for-profit corporation tasked with assisting the SEC. A large portion of its revenues stem from fines imposed on members and holding dispute resolution proceedings. In fact, in 2015, FINRA received over $93 million in fines and $41 million in dispute resolution revenues.[242] Together, those fees account to more than 13% of FINRA's entire revenues. WHM was fined over $228,000. This WHM fine correlates to no injury, no fraud and no damages in this case.

K. FINRA Acted Outside Its Scope of Regulatory Authority.

The SEC may sanction broker-dealers for violations of federal securities laws. The authority of FINRA to sanction its members is limited by the Exchange Act. FINRA's authority to sanction member firms and their associated persons is governed by §§15A and 19 of the Exchange Act. §§15A(b), 15A(h) and 19(g) expressly limit FINRA's disciplinary authority to violations of the Exchange Act.

Concerning RSAs, §15A(h) provides: "A determination by the association to impose a disciplinary sanction shall be supported by a statement setting forth... the specific provision of *this chapter*, the rules or regulations thereunder,... or the rules of the association which any such

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[240] *Mathews v. Eldridge*, 424 U.S. 319, 344 (1976).
[241] *Joint Anti-Fascist Committee v. McGrath*, 341 U.S. 123, 172, (1951) (Frankfurter, J., concurring).
[242] RP 14473.

act or practice, or omission to act, is deemed to violate."[243] §15A(b) contains an identical grant of disciplinary authority.[244] Concerning SROs, §19(g) requires an SRO to "comply with the provisions of *this chapter*, the rules and regulations thereunder, and its own rules."[245] Thus, based on the direct statutory language of the Exchange Act, it is clear that RSAs and SROs only have the authority to enforce violations of *this chapter*, i.e., violations of the Exchange Act. Thus, FINRA has no statutory authority to enforce the Securities Act, yet in this case it did.

L. Arbitrary Forum Selection

Instead of bringing the enforcement action in federal court, The DOE brought the action in its own forum, where it has the home field advantage, its own references, and is subject to few, if any, of the protections provided to defendants in federal court. WHM had no right to a jury, discovery, and rules of evidence or any of the safeguards provided in federal courts.

M. The SEC Is the Sole Regulator to Discipline RSA/SRO Members for Violating the Securities Act

§19(h) names the SEC as the only regulatory body with the statutory authority to sanction RSA and SRO members for violations of the Securities Act and other federal securities laws.[246] §3 of the Exchange Act, in turn, defines the "appropriate regulatory agency" for an RSA as the SEC.[247] The difference between the express grants of disciplinary authority in §§15A(b), 15A(h),

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[243] 15 U.S.C. §78o-3(h)(1)(B) (emphasis added).
[244] *Id.* §78o-3(b)(2), (7)(requiring an RSA (i) to have capacity to "enforce compliance by its members and [associated persons], with the provisions of this chapter, the rules and regulations thereunder,... and the rules of the association" and (ii) to promulgate rules providing for discipline of members "for violation of any provision of this chapter, the rules or regulations thereunder, ... or the rules of the association." (emphasis added).
[245] *Id.* §78s(g)(1)(B)(emphasis added).
[246] *Id.* §78s(h)(3).
[247] *Id.*, §78c(a)(34)(E). Although the Exchange Act does not specifically define the "appropriate regulatory agency for a self-regulatory organization," the surrounding definitions make plain that such an agency must be a governmental body. §78c(a)(34) (listing the Comptroller of the

and 19(g) on one hand, and §19(h), on the other, is clear. While the SEC may sanction broker-dealers for violations of any of the federal securities laws enumerated in §19(h), the authority of FINRA to sanction its members is limited to violations of the Exchange Act.

When Congress added §19 to the Exchange Act in 1975, it used the phrase, "the Securities Act of 1933 and "the securities laws" – a term §3 defines to include the Securities Act, the Exchange Act, and the Investment Company Act of 1940, among other federal laws.[248] In the subsections relating to FINRA's jurisdiction, Congress opted neither to list the Securities Act by name, as in §19(h), nor to use §3's inclusive shorthand. This confirms a specific Congressional intent to limit FINRA's disciplinary authority to violations of the Exchange Act only.

The notion Congress denied FINRA the authority to enforce the Securities Act has a logical explanation: The Securities Act concerns issuances of securities, and FINRA lacks jurisdiction over corporate issuers.[249] The capacity to fully develop a record as to whether a securities distribution satisfied §5 and its numerous exemptions depends on substantial amounts of information that FINRA has no power to collect. In contrast, the SEC can collect such information through governmental subpoena powers and federal court proceedings. Accordingly, FINRA cannot be expected to generate a fulsome factual record and conduct a fair and adequate hearing on a §5 issue.

N. Violations Of The Appointments Clause

FINRA Hearing Officers who preside over the enforcement proceeding in this matter are "inferior officers" within the meaning of the Appointments Clause of the Constitution, art. II, §2, cl.2, whose appointment was required to be made, but was not made, in accordance with the

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Currency, the Board of Governors of the Federal Reserve System, the FDIC, and the SEC as "appropriate regulatory agenc[ies]" of different market participants).

[248] *Id.* §78c(a)(47). Securities Acts Amendments of 1975, sec. 17(c), §21(g), 89 Stat. at 155.

[249] Self-Regulatory Organizations, Exchange Act Release No. 62434 (July 1, 2010).

Appointments Clause. Under the Appointments Clause, inferior officers may be appointed by the President, a court of law, or a department head. Employees, who are "lesser functionaries subordinate to officers of the United States," are outside the ambit of the Appointments Clause. The Hearing Officer is an employee of FINRA and was not properly appointed in accordance with the Appointments Clause.

CONCLUSION

WHEREFORE, ALL PREMISES CONSIDERED, Respondents respectfully request the SEC reverse, vacate and dismiss the Decisions with prejudice and grant Respondents the relief requested. Alternatively, Respondents respectfully request that the SEC reduce or eliminate the sanctions rendered against Respondents and/or reverse the findings of fact and law in the Decisions.

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CERTIFICATE OF COMPLIANCE

I certify that on the foregoing Opening Brief in the Matter of Application for Review of William H. Murphy & Co., Inc. and William H. Murphy, Administrative Proceeding No. 3-18895, does not exceed 14,000 words, exclusive of the table of contents and authorities, cover page, request for oral argument and signature pages.

CERTIFICATE OF SERVICE

I certify that on this day, January 10, 2019, I caused the original and three copies of the foregoing Opening Brief in the Matter of Application for Review of William H. Murphy & Co., Inc. and William H. Murphy, Administrative Proceeding No. 3-18895, to be served on the parties listed below

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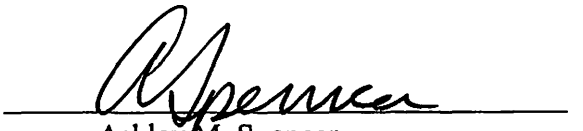

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