ADMINISTRATIVE PROCEEDING



FILE NO. 3-14104r

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Application of

SHAREMASTER
c/o Howard Feigenbaum
460 Tewell Drive
Hemet, CA 92545

For Review of Action Taken by

FINRA

# SHAREMASTER'S BRIEF IN RESPONSE TO COMMISSION'S ORDER OF APRIL 17, 2017

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# TABLE OF CASES and STATUTES

Regarding the Commission's Order for a brief in support of the application for review:

## I. COMMISSION'S JURISDICTION OVER SHAREMASTER'S APPLICATION FOR REVIEW IN LIGHT OF THE NINTH CIRCUIT'S DECISION

The Ninth Circuit Court of Appeal's decision established the Commission's jurisdiction over Sharemaster's Application for Review through a finding that the disciplinary sanction, imposed by FINRA in the Hearing Panel Order of October 6, 2010, remained "live."[1] The Court pointed to a $1000 late filing fee imposed by FINRA.

On May 3, 2010, a $1000 fee for late filing was included in FINRA's Notice of Suspension et al. to Sharemaster under the heading Assessment of Fees. This notice of Assessment of Fees was referenced in Appellant's Supplemental Letter Brief to the 9th Circuit, September 26, 2016.

> Pursuant to Section 4(g) of Schedule A to FINRA's By-Laws, FINRA is imposing a fee on your firm for failure to timely file the required annual audit....
>
> Accordingly, your assessed fee is $1000, which will automatically be deducted from your firm's Central Registration Depository ("CRD") account.[2]

FINRA's attorney asked the Hearing Panel to uphold the sanctions listed in Complainant Exhibit No.1.[3] This issue was also discussed in the June 25, 2012 Sharemaster's Response to the Commission's Order Scheduling Briefs on Remand, p.12, Appendix B-3.

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[1] Sharemaster v. SEC, 9th Cir. Feb. 2, 2017, p.24.
[2] Ibid. p.2; Complainant's Exhibit No. 1, p.2, in evidence (CX-1), FINRA Hearing Decision, p.2.
[3] Transcript, p.16.

In fact, FINRA deducted $1000 from Sharemaster's CRD account.

Attachment-A, in Appendix, is a copy of the CRD transaction sheet which described the deduction as FINRA Annual Audit Late Fee.[4] FINRA has retained the fee.

The Court of Appeals stated, "...Sharemaster's challenge to FINRA's final disciplinary sanction is subject to review by the Commission pursuant to Section 19(d)(2)."[5]

The Court's Order directed the Commission to determine whether or not Sharemaster prevails in its argument as to the applicability of the PCAOB-registered accountant requirement.[6]

As a consequence of the Appellate Court's reasoned consideration and ruling, it is clear that there is a live issue which requires the Commission to hear Sharemaster's petition for review of the FINRA Order and to determine the use and applicability of the exemption claimed by Appellant throughout.

## II. THE MERITS OF SHAREMASTER'S PETITION FOR REVIEW

February 2010, Sharemaster filed a timely annual statement with FINRA, invoking a Securities Exchange Act exemption allowing the filing of an annual statement that need not be audited. Rule 17a-5(e)(1)(i)(A) applies to brokers who act as agents in soliciting subscriptions for issuers. To qualify, the exemption requires that the broker not hold customers' funds or securities or owe money or securities to customers. Further, Exchange Act Rule 17a-

[4] CRD transaction sheet, Attachment-A, Appendix, p.17.
[5] Sharemaster v. SEC, Callahan, II, B.
[6] Ibid.

5(e)(1)(2) requires that a firm filing an unaudited statement also include an oath or affirmation and a statement of the facts and circumstances relied upon as a basis for using the exemption.[7] Sharemaster complied with the Rule.[8]

May 3, 2010, FINRA refused the firm's timely-filed annual statement and deemed it "not filed."

May 14, 2010, FINRA assessed a $1000 Annual Audit Late Fee which was withdrawn from the firm's CRD account.[9]

May 17, Sharemaster requested a hearing on the matter of the annual statement filing.

On June 24, 2010, FINRA conducted an expedited hearing regarding the annual statement filing.

October 6, 2010, the Hearing Panel Decision found in favor of FINRA Member Regulation, based on an SEC staff interpretation of the exemption found in a series of SEC Staff No-Action Letters. The staff interpretation limited the use of the statutory exemption to soliciting subscriptions for a "single issuer."[10]

The FINRA Order suspended the firm until it filed the "requisite annual report" and assessed fees and costs. The Order also stipulated that "at the end of six months, the suspension will convert to an expulsion if Respondent has at that time not filed a properly audited annual report for 2009."[11]

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[7] FINRA Hearing Panel Decision, p.3.
[8] Respondent's Exhibit 9 (RX-9).
[9] CRD transaction sheet, Attachment-A, Appendix, p.17.
[10] FINRA Hearing Panel Decision, p.5, footnote 12.
[11] FINRA Hearing Panel Decision, pp. 5-6.

November 1, 2010, under financial duress from suspension and impending expulsion, Sharemaster filed a PCAOB-audited annual statement.

January 24, 2011, FINRA lifted Sharemaster's suspension.

### A. Exchange Act Rule 17a-5(e)(1)(i)(A) is clear and unambiguous—requiring no interpretation.

"First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."[12]

Sharemaster contends that the Exchange Act Rule is clear and unambiguous. At the heart of the matter is the protection of customer assets—funds and securities—from abuse by firm's holding them. The exemption recognizes that many firms do not hold or owe customer funds and securities and act only as agents. The statute declares that these types of firms need not file audited annual statements.

The SEC's interpretation, applying a "single issuer" meaning to soliciting subscriptions, conflicts with the Rule. The Rule does not use the word "single." To insinuate the word, thereby, renders Congressional intent severely weakened and the exemption useless. The purpose of the statute Rule 17a-5(e)(1)(i)(A) is blunted: to provide relief from the burden of filing a costly audited annual statement when the broker (agent) does not have custody of securities or money or doesn't owe either to customers.

[12] Chevron U.S.A. v. NRDC, 467 U.S. 837, 842-43 (1984).

It is unreasonable for SEC staff to interpret, and for the FINRA Hearing Panel to accept, that in the statute's construction Congress intended to provide relief for only those brokers who solicited subscriptions for a single issuer. It is additionally unreasonable to assume that the statute's intent was to limit a broker (agent's) business "...to the sale of one mutual fund, in effect, one distinct fund, one distinct mutual fund, one distinct issuer."[13]

The Dictionary Act states that "unless the context indicates otherwise, words importing the singular include and apply to several persons, parties, or things; words importing the plural include the singular."[14]

**B. The SEC No-Action Letters' "single issuer" interpretation of Exchange Act Rule 17a-5(e)(1)(i)(A) is in conflict with the usage and meaning of the term "issuer" used in Exchange Act Rule 17a-5(c)(1)(ii), found in the same section.**

The SEC Staff Interpretation of "single issuer" conflicts with the meaning of the term "issuer" used in a preceding part of the statute. In Exchange Act Rule 17a-5(c)(1), regarding which firms are obligated to send customers statements of account, an exception is made for firms which promptly forward:

> ...subscriptions for securities to the issuer, underwriter or other distributor of such securities and of receiving checks, drafts, notes, or other evidences of indebtedness payable solely to the issuer, underwriter or other distributor who delivers the security directly to the subscriber or to a custodian bank, if the broker or dealer does not otherwise hold funds or securities for, or owe money or securities to, customers;[15] [underline added]

[13] Transcript 49-50.
[14] 1 U.S.C. §1.
[15] Exchange Act Rule 17a-5(c)(1)(ii).

"A term appearing in several places in a statutory text is generally read the same way each time it appears."[16] The term "issuer" used in the customer account statement exception and the term "issuer" used in the exemption from filing an audited statement are the same—not limited to a "single issuer." Both include the same qualification for triggering an exemption—not holding funds or securities for, or owe money or securities to customers.

A well-established canon states that "similar language contained within the same section of a statute be accorded a consistent meaning."[17]

FINRA's use of the SEC No-Action Letters, restricting the exemption's application to a "single issuer," goes against the common sense and purpose of Exchange Act Rule 17a-5(e)(1)(i)(A) and conflicts with the consistent meaning of language used within a similar rule in the same section of the statute.

### C. SEC Staff No-Action Letters Fail to Provide Any Reason or Explanation for the interpretation's existence.

In the Letters, SEC staff fails to provide justification for reaching their "single issuer" opinion. No deficiency or ambiguity in the statute is cited, nor is there any explanation of how the interpretation supports the statute's operation or Congressional intent.

One must ask what is the critical difference that occurs when a broker solicits subscriptions for two issuers—rather than one? The interpretive letters are silent about the reason for the restriction.

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[16] Ratzlaf v. United States, 510 U.S. 135, 143 (1994)

[17] National Credit Union Admin. v. First Nat'l Bank & Trust Co., 522 U.S. 479, 501(1998).

The FINRA Hearing Panel Decision stated that the "SEC's long-standing interpretation of its own rule...is the correct interpretation of the Exemption."[18] The Decision does not declare why the interpretation is correct. If a FINRA member has complied with the statute but not with the interpretation, and sanctions result from the Hearing Panel's determination, there is a responsibility to put forth a reasonable explanation.[19]

Since the interpretation is the result of SEC staff opinion and is not the result of the rulemaking process, it would appear to be imperative that the Hearing Panel Decision provide a reasonable, clearly-stated explanation.

### D. The Hearing Panel's Conclusions of Law are incomplete and, therefore, incorrect.

The Hearing Panel' Conclusion of Law cites three things:

(1) The SEC interpretation is longstanding,

(2) The SEC has interpreted its own rule and

(3) The Hearing Panel is persuaded that it is the correct interpretation of the Exemption.[20]

Sharemaster understands how the Panel reached its decision—but not why. Was there something about the interpretation that justifies its use? If Sharemaster is to be sanctioned for not obeying an interpretation of a statutory rule, the interpretation should be more than "persuasive," it should be explained in a clear and unambiguous manner.

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[18] FINRA Decision, p.5.
[19] Encino Motorcar v. Hector Navarro, et al. 579 U. S. ____ (2016).

[20] FINRA Decision, p.5.

The Panel's Conclusion of Law lacks a rational connection between facts and judgment and goes beyond the limits of acceptability.[21]

This failure (to give adequate reasons for severely limiting use of the exemption) makes the interpretation procedurally defective. Because of the absence of a minimal level of analysis in support of a regulatory rationale, the interpretation is rendered "arbitrary and capricious and so cannot carry the force of law."[22]

### E. The FINRA Hearing Panel Ruling conflicts with a previous FINRA Hearing Panel Decision allowing the use of the exemption.

A FINRA Hearing Panel Decision in September 2006 granted a member firm the use of the exemption in filing unaudited annual statements for the years 2005 and 2006. The firm claimed the exemption under Rule 17a-5(e)(1)(i)(B) and filed a statement of facts and circumstances that it relied upon for using the exemption, as required by Rule 17a-5(e)(1)(2). The firm's business was limited to buying and selling evidences of indebtedness secured by mortgage, deed or trust, or other lien upon real estate or leasehold interest....[23]

Although the "single issuer" No-Opinion Letters existed at the time of the 2006 hearing, FINRA did not assert that the firm in question was prohibited from using the exemption based on the "single issuer" precedent. The FINRA Hearing Panel found that the member firm properly claimed the exemption.[24]

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[21] United States, Inc. v. State Farm Mutual Automobile Insurance 463 U.S. 48 (1983); *Burlington Truck Lines, Inc. v. United States,* 371 (c) U.S. at U. S. 157.
[22] Encino Motorcar v. Hector Navarro, et al. 579 U. S. ____ (2016).
[23] Respondent's Exhibit 8 (RX-8), OHO Redacted Decision FPI06008, Hearing Panel Decision, dated September 15, 2006, in evidence; Transcript pp. 61-62.
[24] RX-8, p.4.

Sharemaster made the same claim under part (A) of the exemption and with the same qualifications when filing the firm's 2009 annual statement. In the June 2010 Hearing, Sharemaster raised the precedent of the 2006 Hearing and entered into evidence the 2006 Hearing Decision and Order.[25]

The differing result in the September 15, 2006 Hearing Panel Decision and the instant case creates regulatory uncertainty, unreliability and the idea of unequal treatment in enforcement.

The 2006 FINRA Hearing outcome, an adjudicatory process, casts doubt as to the value of the SEC No-Action Letters interpretation and whether the interpretation was, indeed, "longstanding" at the time of Sharemaster's FINRA Hearing in June 2010. The 2006 Hearing Decision interrupted the assertion of longstanding status.

No-Action Letters are used to encourage a desired behavior while adjudication is a process for formulating an order and a course of action. Adjudication decisions may become precedent that bind future parties. The latter must be given greater weight.

In the FINRA action against Sharemaster, the SEC No-Action Letters, have dates ranging from 1981 to 1991 and are addressed to private parties.[26]

In February of 2010, Sharemaster filed its annual statement using the same procedure as the firm in the 2006 FINRA action.

In June 2010, for the purpose of litigation, after filing notice against Sharemaster in May, FINRA solicited a Letter from the SEC's Division of

[25] Transcript p.60; Respondent's Exhibit 8 (RX-8).
[26] CX-11

Trading and Markets. The purpose of the Letter was to reassert the broken chain of the "single issuer" interpretation in contravention of the 2006 FINRA adjudication.[27]

Since Sharemaster is appealing a Decision under FINRA's jurisdiction, and since the No-Action Letters are not the result of rulemaking or adjudication and are hortatorical, the precedent set in the 2006 FINRA Hearing is meaningful. FINRA's solicitation of a current (June 2010) iteration of the interpretation, rather than relying on pre-1992 Letters, may be seen as an attempt to retroactively (ex post facto) rehabilitate the interpretation.

**F. The negative impact of a longstanding interpretation in No-Action Letters on small firms.**

The longstanding SEC staff-promulgated interpretation limiting use of the exemption causes particular hardship to small FINRA firms and has harmful effects that are not readily apparent and are not in public view.

FINRA's requirement, that beginning with the 2009 fiscal year all firms file a PCAOB-audited annual statement, imposes a particular financial hardship on small firms. For Sharemaster, the accounting fee for preparing an annual statement in 2008 was $585. The accounting fee for the firm's annual statement in 2009, after the PCAOB requirement, was $2800. This increase was exorbitant for a small firm, with a modest income, which acts as an agent

[27] Complainant's Exhibit 12 (CX-12), in evidence, Hearing Panel Decision, p.5.

in soliciting subscriptions and does not hold or owe customer securities or funds.[28]

What happens to firms who can't meet the cost of PCAOB accountants? Per a FINRA Hearing witness, they go out of business "...because the revenue does not exceed the expenses."[29] The use of a statutory exemption granting the filing of an annual statement that need not be audited relieves this oppressive financial burden. Sharemaster has argued that such relief is the purpose of the exemption.[30]

The Sarbanes-Oxley amendments to the Exchange Act of 1934 did not remove the audit exemption in Rule 17a-5(e)1)(i)(A). Sarbanes-Oxley merely added the requirement that statements which require an audit are prepared by a PCAOB-registered auditor and did not affect the exemption.[31]

There is a lack of review by Congress and the Executive regarding issues of agency interpretation. Small firms are politically limited in their ability to garner such attention. The issue does not reach review since a presumption exists in favor of deference to agency views. This policy can conceal from consideration the rights of parties whose legal interests are unfairly affected by the deference process.

**G. A reasonable apprehension of not receiving a fair hearing.**

Appellant has a reasonable apprehension of not receiving a fair hearing. This apprehension is a result of (1) the fact that the "single issuer"

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[28] Transcript pp.135-136.
[29] Transcript, p.76.
[30] Transcript, p129.
[31] Transcript, p.127; The Sarbanes-Oxley Act of 2002

interpretation was promulgated by SEC staff. (2) An SEC employee, working in the Division of Trading and Markets, at FINRA's request, participated in the prosecution of the FINRA action by providing evidence in the form of the interrupted longstanding interpretative Letters.[32] (3) The SEC is the reviewing body for Sharemaster's appeal.

Appellant believes that the SEC strongly disfavors use of the exemption, as evidenced in the FINRA Hearing by the SEC's renewed June 2010 affirmation in support of the "single issuer" interpretation. This predisposition may influence the Commission's judgment.

Obstacles to fairness which are reasonable possibilities include: (1) biased assimilation, a tendency to interpret information in a way that supports a desired conclusion and (2) confirmation bias, a tendency to look first for information that confirms a desired conclusion.

Because the SEC has a conflict of interest between a desired policy outcome and serving as a fair and independent tribunal, Appellant contends that the Commission may be biased in reviewing this case.

### H. Appellant has a legally protected interest in Exchange Act Rule 17a-5(e)(1)(i)(A).

Appellant suffered an invasion of a legally protected interest in the statute when FINRA refused to accept Sharemaster's annual statement timely-filed February 2010.

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[32] Transcript, pp.35-36.

There are four elements that support a finding of the invasion of a legally protected interest:

(1) *Injury in Fact*: The Hearing Panel Order concurred with FINRA's reliance on an SEC interpretation of Exchange Act Rule 17a-5(e)(1)(i)(A), which precluded Sharemaster's use of the exemption in the statute.

As a result of the ruling, Sharemaster, a sole proprietorship owned by Howard Feigenbaum, sustained an injury in fact which is actual, concrete and particularized: (a) denied use of the aforementioned noted exemption, (b) assessed an unwarranted $1,000 late filing fee and (c) and has accrued, to date, accounting costs in the sum of $16,830.[33]

(2) *Causation*: In February 2010, Sharemaster timely filed its annual statement in compliance with Exchange Act Section 17a-5, and exercised the exemption under Rule 17a-5(e)(1)(i)(A). FINRA refused to accept the annual statement as filed and deemed it "not filed," setting this dispute in motion and causing Sharemaster to incur a late filing fee.

As noted above, the Order caused an increased expense to Sharemaster for accounting fees for the 2009 annual statement, rising from $585 to $2800 (and more in subsequent years), as a result of

[33] Ibid.

requiring an annual audited statement prepared by a PCAOB-registered accountant.[34]

(3) *Redressability*: Review of the FINRA Order can bring relief to Appellant.

The issue of redressability is best-stated in the 9th Circuit Court ruling:

> ... if Sharemaster prevails on the merits of his argument (that he was not required to use a PCAOBregistered accountant), the Commission would be compelled to set aside the $1,000 fine because Sharemaster, in fact, timely complied with securities laws.[35]
>
> ...we conclude that the disciplinary sanction imposed by FINRA remained live based on the $1,000 fine. Accordingly, Sharemaster's challenge to FINRA's final disciplinary sanction is subject to review by the Commission pursuant to Section 19(d)(2). We leave it to the Commission to determine on remand whether, if Sharemaster prevails on the merits of its argument regarding the applicability of the PCAOB-registered accountant requirement, the Commission may direct FINRA to reinstate Sharemaster nunc pro tunc.[36]

(4) *Zone of Interest*: Sharemaster's injury in fact, resulting from the October 6, 2010 FINRA Order, is the type protected by Exchange Act Rule 17a-5(e)(1)(i)(A). The rule specifically grants relief from the financial burden of an audited statement to a firm that doesn't hold or owe customer funds or securities and acts as an agent.

**Conclusion**:

The October 6, 2010 FINRA Order, precluding use of the statutory exemption, is faulty. The interpretation used in the decision offers no

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[34] Transcript, pp.135-136.
[35] Sharemaster v. SEC, pp. 21-22.
[36] Sharemaster v. SEC, p.24.

explanation or reason for a restriction in the use of the exemption and is arbitrary and capricious.

The interpretation conflicts with the meaning and usage of the term "issuer" as used in Exchange Act Rule 17a-5(c)(1)(ii). The FINRA Hearing Panel Decision does not provide an explanation as to why the interpretation is correct or reconcile a difference in enforcement results found in the September 2006 adjudication which allowed the use of the exemption.

It is Appellant's position that the SEC staff interpretation does not have the force of law.

In this case, the interpretation unreasonably amends the statute and deprives Sharemaster of a legally protected interest in the statute: the right to use the exemption and to not suffer ongoing injury.

Appellant asserts that the October 6, 2010 FINRA Order, which removes Sharemaster's use of a protected interest granted by statute, constitutes a "final disciplinary sanction" reviewable by the Commission under Sections 19(d)(1) and19(d)(2).

Appellant asks the Commission to:

(1) Set aside the October 6, 2010 FINRA Hearing Panel Order as herein above discussed;

(2) Order FINRA to reinstate Sharemaster's February 2010 timely filing of its annual statement, pursuant to the exemption provided by Exchange Act Rule 17a-5(e)(1)(i)(A);

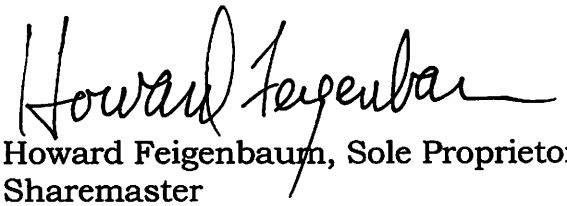
(3) Order FINRA to remove from public record any derogatory references to Sharemaster violating FINRA and Exchange Act and FINRA rules;

(4) Order FINRA to return the $1,000 late filing fee assessed by FINRA, pursuant to Exchange Act Sections 19(e)(1) and 19(e)(2);[37]

(5) Order FINRA to make Appellant whole by reimbursing Sharemaster for the difference in accounting fees between pre-PCAOB fees and post-PCAOB fees.[38]

Thank you for your consideration.

Respectfully submitted,



Howard Feigenbaum, Sole Proprietor May 13, 2017
Sharemaster
460 Tewell Drive
Hemet, CA 92545

[37] Sharemaster v. SEC, p.22.
[38] Sharemaster Accounting Costs, Attachment-B, Appendix, p.17.

# APPENDIX

Transaction Detail

**Organization CRD#:** 24019
**Organization SEC#:** 8-40906
**Account Status:**
**Account Balance:**
**Balance As Of:**
**Funds Deficient Transactions:**
**Processed Transactions:**
**Current Amount Due:**

**Organization Name:** SHAREMASTER
**Applicant Name:** FEIGENBAUM, HOWARD
Deficient
$99.00
02/14/2011 01:03:58 AM
$0.00
$0.00
$99.00

**Search Parameters:**

**Post Date** From: 05/03/2010 To: 05/31/2010

Search | Reset

**Total Transaction Amount** $1,000.00
**Total Transaction Count** 1

Records per Page: 25 Total Records: 1

| Post Date | Transaction Date | Transaction# | Description | Individual Name | Individual CRD# | Branch CRD# | Amount |
|---|---|---|---|---|---|---|---|
| 05/14/2010 | 05/13/2010 | | FINRA Annual Audit Late Fee | CAS-69442-H14X7X | | | $1,000.00 |

Records per Page: 25 Total Records: 1

ATTACHMENT A

# Sharemaster Accounting Fees

Pre-PCAOB Fee:

| | | | | |
|---|---|---|---|---|
| 2009 | Mark Nathanson, CPA | $585 | | |

Post-PCAOB Fees

| | | | | |
|---|---|---|---|---|
| 2010 | Tarvaran, Askelson, CPA's | $2800 | -585= | $2215 |
| 2010 | Tarvaran, Askelson, CPA's | $2800 | -585= | $2215 |
| 2011 | Tarvaran, Askelson, CPA's | $2800 | -585= | $2215 |
| 2012 | Elizabeth Tractenberg, CPA | $1800 | -585= | $1215 |
| 2013 | Elizabeth Tractenberg, CPA | $2160 | -585= | $1575 |
| 2014 | Elizabeth Tractenberg, CPA | $3050 | -585= | $2465 |
| 2015 | Elizabeth Tractenberg, CPA | $3050 | -585= | $2465 |
| 2017 | Elizabeth Tractenberg, CPA | $3050 | -585= | $2465 |
| 2018 | Elizabeth Tractenberg, CPA | $3050 | -585= | $2465 |

Difference in accounting fees between pre-PCAOB fees versus post-PCAOB fees. $16,830

ATTACHMENT - B

**CERTIFICATE OF SERVICE**

In the Matter of the Application of

Sharemaster

For Review of Disciplinary Action Taken by FINRA

File No. 3-14104r

SHAREMASTER'S BRIEF IN RESPONSE TO

COMMISSION'S ORDER OF APRIL 17, 2017

I hereby certify that on May 13, 2017, I caused a copy of the foregoing Applicant's Brief in Response to Commision's Order of April, 17, 2017, to be served on Mr. Alan Lawhead, Office of the General Counsel, FINRA, by Federal Express.

Mr. Alan Lawhead

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