

3-17512

Before the  
SECURITIES AND EXCHANGE COMMISSION

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Department of Enforcement,	:
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	: <b>NOTICE OF APPEAL</b>
Complainant,	:
	:
v.	:
	: <b>FINRA DISCIPLINARY</b>
	: <b>PROCEEDING No. 2011025851501</b>
KCD Financial, Inc. (CRD No. 127473),	:
	:
Respondent.	:
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**NOTICE OF APPEAL**

Pursuant to Section 19(d)(1) of the Exchange Act, Section 201.420 of the Rules of Practice of the Securities and Exchange Commission (the "Commission"), and FINRA Rule 9370, KCD Financial, Inc. ("KCD" or the "Firm"), through its undersigned counsel, hereby appeals to the Commission from the Decision of FINRA's National Adjudicatory Council (the "NAC"), dated August 3, 2016, in Disciplinary Proceeding No. 2011025851501 (the "Decision").

**Introduction**

While the Decision includes two unrelated causes of action, KCD appeals only from the Decision related to the second cause of action involving a purported general solicitation of an unregistered offering. (See pages 16-34 of the Decision). KCD hereby challenges the NAC's determination that:

- (1) the newspaper articles that form the basis of the general solicitation claim solicited offers to purchase unregistered securities;

- (2) KCD failed to proffer sufficient evidence to prove that the Firm offered and sold the unregistered securities only to the Firm's pre-existing, accredited customers by means other than through the newspaper articles;
- (3) KCD failed to supervise its representatives' sales of the unregistered securities; and
- (4) if the NAC's Decision is sustained, that KCD's handling of the unregistered offering warrants a \$73,000 fine.

KCD further appeals from the NAC's decision, dated March 7, 2016, in which it denied KCD's request to introduce newly discovered evidence related to the Commission's investigation of the exempt private offering at issue herein.

For the reasons set forth below, KCD asserts that the NAC erred in finding against KCD, and the Decision regarding the exempt private offering of unregistered securities should be overturned in its entirety.

### **KCD's Basis For Appeal**

#### **The Exempt Private Offering**

In its Decision, the NAC erred in finding that KCD's representatives offered and sold interests in an unregistered offering of the WRF Distressed Residential Fund 2011 (the "WRF Fund") pursuant to a general solicitation. First, the NAC erred in finding that two articles published by two Dallas, Texas area newspapers that discussed the WRF Fund during the solicitation period constituted a general solicitation because the articles did not solicit offers to purchase interests in the WRF Fund. The articles, which resulted from a press release sent out by the issuer of the WRF Fund, were aimed at owners of distressed property from whom the WRF Fund sought to purchase investment properties. The NAC acknowledged as much when it stated that the articles "informed owners of distressed properties and nonperforming loans that

Westmount Realty Finance was a buyer in that market.”<sup>1</sup> The NAC, nonetheless, erroneously determined that this fact did “not negate our finding that those communications were designed to arouse interest in the WRF Fund”<sup>2</sup> even though it failed to point to anything in the articles indicating that the WRF Fund was seeking investors for Fund.<sup>3</sup>

KCD also appeals from the NAC’s determination that the Firm failed to prove that its representatives had offered and sold interests in the WRF Fund only to its group of pre-existing, accredited customers. In its Decision, the NAC recognized that former Commission Chairwoman Mary Shapiro had stated that “the proper analysis of whether a general solicitation occurred focused on whether the investors participating in the offering were actually solicited through the activities which could be viewed as a general solicitation or if, for example, the investors were existing clients or those with whom a pre-existing relationship existed.”<sup>4</sup> The NAC also acknowledged that two of KCD’s witnesses testified (under oath) that all of the interests in the WRF Fund were sold only to investors with whom KCD had a prior existing relationship.<sup>5</sup> But, even though FINRA failed to present any challenge to either of the witnesses’ testimony, the NAC erroneously determined that that KCD had “not proved with sufficient evidence that the only persons who actually invested in the WRF Fund were ones solicited through ‘legitimate means’” rather than the newspaper articles.<sup>6</sup>

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<sup>1</sup> Decision at p. 25.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.* at 17-18, 23-25.

<sup>4</sup> *Id.* at 26 (quoting an April 6, 2011 letter from Mary Shapiro, Commission Chairman, to Darrell E. Issa, Chairman, House Committee on Oversight and Government Reform, at 8).

<sup>5</sup> *Id.* at 27.

<sup>6</sup> *Id.* (quoting 1 Harold S. Blumenthal and Samuel Wolff, *Securities Law Handbook*, at 653 (2014 ed.) (noting that Chairperson Shapiro, in her April 6, 2011 letter to Issa, “seems to be saying that the proper analysis is whether the investors in the offering came into the offering through legitimate means rather than through the general solicitation, and that this analysis applies even if the possible general solicitation is made by means other than a registration statement”).

The NAC also erroneously found that KCD failed to prove that all of the WRF Fund investors were accredited.<sup>7</sup> In so finding, the NAC failed to credit not only the uncontroverted testimony of two of KCD's witnesses who stated, under oath, that all the investors were accredited,<sup>8</sup> but also the testimony of the FINRA examiner who had reviewed a good-sized sampling of KCD's relevant customer files and found no issues regarding the suitability of the investments for the customers.<sup>9</sup>

### **Supervision of the Unregistered Offering**

KCD also appeals from the NAC's determination that KCD failed to supervise its representatives' sales of the WRF Fund.<sup>10</sup> The findings in the NAC's Decision are focused on KCD's continued sales of interests in the WRF Fund after the newspaper articles were published.<sup>11</sup> But, as set forth above, the publication of the newspaper articles alone is not determinative of whether KCD sold securities in violation of Section 5 of the Securities Act of 1933 ("Section 5"). As indicated by Chairwoman Schapiro's comments (as well as other Commission guidance discussed in KCD's briefs), the question as to whether or not the WRF Fund was entitled to claim an exemption from the registration requirements revolves around whether the investors participating in the offering were actually solicited by the newspaper articles.<sup>12</sup> Instead of failing to supervise its representatives, KCD's actions insured that all of the WRF Fund interests were sold only to accredited, pre-existing customers who were offered interests in the WRF Funds by means other than the newspaper articles. FINRA failed to present any evidence to the contrary. It did not, for example, show that because of KCD's supervisory

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<sup>7</sup> *Id.* at 27.

<sup>8</sup> *Id.*

<sup>9</sup> Hearing Transcript at 278:14-280:5.

<sup>10</sup> Decision at. 28-30.

<sup>11</sup> *Id.*

<sup>12</sup> *See id.* at 26-27.

failures, interests in the WRF Fund were sold to either non-accredited investors and/or investors who learned about the offering through the newspaper articles. As such, KCD challenges the NAC's determination that FINRA met its burden of proving KCD failed to supervise the WRF Fund offering.

### **Sanctions**

KCD also challenges the excessive sanctions imposed by the Hearing Panel and only slightly modified downward by the NAC for the following reasons:

- The NAC erroneously found that the lack of customer harm in this case is not mitigating.<sup>13</sup>
- The sanction imposed is punitive and serves no remedial purpose because KCD's handling of the WRF Fund offering represented a unique circumstance. FINRA presented no evidence and no findings were made that KCD engaged in a pattern or practice of selling unregistered securities without an exemption from the registration requirements even though KCD was and is involved in numerous unregistered offerings.
- The Hearing Panel and the NAC improperly relied on the 2015 version of the Sanction Guidelines, which was implemented only after the parties submitted their final post-hearing briefs.<sup>14</sup>

### **Submission of Newly Discovered Evidence**

KCD also appeals from the Subcommittee of the NAC's denial of the Firm's motion to submit newly discovered evidence relating to the Commission's investigation of the WRF Fund (along with other WRF offerings).<sup>15</sup> KCD not only demonstrated that it had good cause for failing to introduce the evidence during the Hearing, but also that the evidence was material to KCD's defense.

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<sup>13</sup> *Id.* at 33. See also *FINRA Sanction Guidelines* at 6 (Principal Consideration in Determining Sanctions No. 11 states that adjudicators should consider "whether the respondent's misconduct resulted directly or indirectly in injury" to other parties, including the investing public, and "the nature and extent of the injury").

<sup>14</sup> *Id.* at 31 n. 37.

<sup>15</sup> *Id.* at 33 n. 48.

As KCD informed the NAC, it learned about the Commission's investigation of the WRF Fund in January 2016 during discussions with the issuer's counsel.<sup>16</sup> KCD had no access to the information before it was revealed by the issuer's attorney. The Commission has never released any publicly available information indicating that it investigated the issuer or the WRF Fund. Moreover, even though KCD made the issuer aware of FINRA's action against the Firm shortly after Enforcement filed its Complaint in November 2013, it was not until the issuer faced KCD's potential indemnification claim that it volunteered any information regarding the Commission's investigation of the WRF Fund.

KCD also demonstrated to the NAC that the newly discovered evidence was material to KCD's defense. The evidence (copies of which were attached to KCD's motions) indicates that the Commission sought and received documents and information from the issuer related to, among other things, the broker-dealers that sold its securities, how investors to the WRF Fund were solicited and whether the investors to the Fund were accredited – the very issues that are at the center of this action. The evidence also indicates that in a letter, dated August 21, 2014, the Commission's staff informed the issuer that it did "not intend to recommend any enforcement action by the Commission at this time." While KCD understands that, pursuant to Securities Act Release No. 5310, the staff's decision is not determinative,<sup>17</sup> the staff's decision not to take any action against the issuer stands in stark contrast to FINRA's findings related to the same facts.

Dated: Dover Plains, New York  
August 26, 2016



Jill G. Fieldstein, Esq.

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<sup>16</sup> The information was revealed after KCD demanded indemnification from the issuer.

<sup>17</sup> KCD understands that, as of the date of this Notice of Motion, the Commission has not taken any action against the issuer for the WRF Fund offering (or for any other reason).



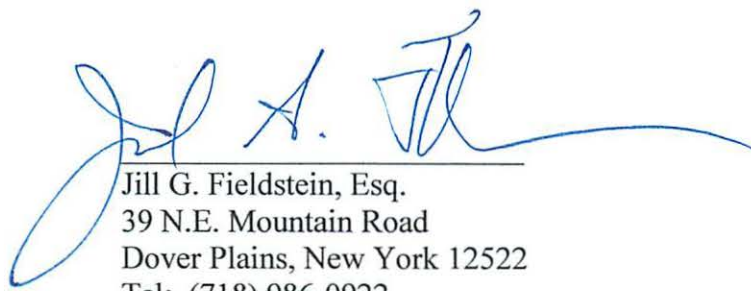
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**CERTIFICATE OF SERVICE**

I hereby certify that on this 26th day of August 2016, I sent by Overnight Mail an original and three copies of the foregoing NOTICE OF APPEAL and NOTICE OF APPEARANCE to The Office of the Secretary, Securities and Exchange Commission, 100 F Street, N.E., Room 10915, Washington, D.C. 20549-1090.

On this 26th day of August 2016, I also sent a copy of the foregoing NOTICE OF APPEAL and NOTICE OF APPEARANCE by Overnight Mail to Michael Garawski, Esq., Office of General Counsel, FINRA, 1735 K Street, N.W., Washington, D.C. 20006. I also sent a courtesy copy of the foregoing to Mr. Garawski by email to michael.garawski@finra.org.

  
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