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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Application of
DAVID ADAM ELGART
For Review Of Disciplinary Action Taken By
FINRA

ADMINISTRATIVE PROCEEDING
File No. 3-17925

APPLICANT'S REPLY BRIEF IN FURTHER SUPPORT OF PETITION FOR REVIEW

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I. ARGUMENT

A. It Is Undisputed that Mr. Elgart Misunderstood The Pertinent Question On His Form U-4.

As much as FINRA argues to the contrary, it is simply unable in any meaningful way to dispute the fact – the uncontroverted fact – that Mr. Elgart misunderstood Question 14M on his Form U-4.[1] It may argue that, in its view, that question is so crystal clear that it has effectively been rendered incapable of being misunderstood, and as a result, that Mr. Elgart's misunderstanding could not possibly have been reasonable. But, even if that is true, it is irrelevant to the disposition of this issue. Under the applicable standard governing whether or not Mr. Elgart's failure to have amended his Form U-4 in a timely manner should be deemed willful or not, it is clear from a prior FINRA decision[2] directly on point that a misunderstanding of a question on Form U-4, absent any other finding, renders such a failure to be not willful. There is nothing in that decision that even suggests the need for that misunderstanding to be "objectively reasonable"[3] to have any efficacy. Thus, FINRA's patent disregard for the undisputed evidence that Mr. Elgart, in fact, misunderstood Question 14M, regardless of whether that misunderstanding was reasonable, is an error that compels the finding of willfulness to be reversed.[4]

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[1] Record at Bates Nos. 524, 528 (Elgart testimony).

[2] *DOE v. Forrest G. Harris,* Disciplinary Proceeding No. C07010084 (May 31, 2002).

[3] FINRA uses the phrase "objectively unreasonable" at pages 18 and 20 of its Response. Notably, there is no citation to any case, SEC or FINRA, that utilized this language. This is a fictitious standard that FINRA is creating here right before our eyes. Clearly, absent formal rulemaking, FINRA cannot simply create new standards in the midst of an Enforcement action and then hold Respondents to such standards.

[4] This same argument also relates to the Personal Activity Questionnaire that Mr. Elgart is accused of having completed inaccurately. Mr. Elgart testified that he harbored the same misunderstanding of the import of the question on the PAQ that addressed his financial circumstances as he did of Question 14M on his Form U-4, notwithstanding the supposed clarity of that question. Again, there is no requirement, or even the hint of a requirement, that his misunderstanding must have been reasonable to vitiate a finding of bad faith.

FINRA vainly attempts to sidestep the clear guidance that *Harris* provides here by suggesting that decision "carries little, if any, precedential value." In other words, we don't like what the hearing panel said in *Harris* back in 2002, so let's just ignore its pesky (albeit pertinent) analysis and focus on other, better – for us, anyway – cases. What is FINRA's justification for this? That the NAC has "extensive powers of review of Hearing Panel decisions." FINRA's Response at p. 19. That is certainly true. But, FINRA, which presumably understands its own rules as well as anyone, is playing a little game of hide-the-ball here: yes, the NAC has extensive powers of review, but, more noteworthy in the *Harris* matter is that the NAC *declined* to call the case for review. If the logic that the hearing panel employed in *Harris* was as fundamentally flawed and troublesome as FINRA argues here, then one would think that the NAC itself, under Rule 9312, would have called that case for review, to reverse the finding, as it does many times when it does not like a hearing panel decision, either the finding of liability, or the sanctions imposed, or both. In fact, that did not happen. Given that, FINRA should not be heard today to argue that somehow the *Harris* decision has no precedential value because the NAC did not weigh in on it. Indeed, the NAC *did* weigh in, tacitly approving the *Harris* decision when it deigned not to call it for review. Thus, the only reasonable conclusion to reach is that the NAC thought that *Harris* was just fine, and not, therefore, it has as much precedential value as any FINRA decision.[5]

[5] Speaking of tacit approval, it is also worth noting that the Department of Enforcement elected not to appeal the *Harris* decision to the NAC, even though it certainly had the right to do so.

B. If It's Not A Matter Of Whether The Misunderstanding Was Reasonable, It Then Comes Down To Whether Mr. Elgart's Testimony Was Credible.

At the root of FINRA's argument in support of the decision is its reliance on certain credibility determinations that the hearing panel made. Knowing that the law requires this Commission to pay deference to such determinations, FINRA uses them as the foundation for its entire case.[6] But, that foundation is not nearly as sound as FINRA maintains.

1. Mr. Elgart's "Vast Industry Experience" Had Nothing To Do With Completing Form U-4.

In a wonderful display of hyperbole, FINRA extols Mr. Elgart's "vast industry experience" as reason to conclude that his unrebutted testimony he misunderstood Question 14M was not credible. FINRA's Response at p. 21. FINRA cites that Mr. Elgart "had decades of industry experience," that he was "a general securities principal, president, and chief compliance officer of his firm," that he "had overarching responsibility for Form U4 registration filings," and that he "electronically signed Form U4 amendments as the 'firm/appropriate signatory.'" All true. But misleading. Remember, Sequoia was a very tiny firm, with less than a half-dozen registered people. To suggest that Mr. Elgart's 45 years in the industry somehow make him a U-4 expert is a leap of logic unsupported by the facts.

Contrary to FINRA's point, Mr. Elgart testified that while he was indeed Sequoia's Chief Compliance Officer, he delegated the responsibility for the occasional Form U-4 amendment to the firm's FINOP.[7] FINRA did not call the FINOP to rebut that assertion, so it stands unrebutted. Moreover, his testimony also provided that the occasional amendments to Form U-4 were for address or registration changes, not to address financial disclosures. Thus, while Mr.

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[6] In an odd twist, in footnote 10, after first arguing that *Harris* should simply be ignored due to its lack of precedential value, FINRA then seems to suggest that the hearing panel there should be credited for having found Mr. Harris to be credible (unlike the hearing panel here). You cannot have it both ways: either *Harris* represents sound and logical – and precedential – reasoning, or it doesn't.

[7] Record at Bates Nos. 491-492 (Elgart testimony).

Elgart, like every other registered person – including, notably, Mr. Harris – is charged with the responsibility to understand his or her disclosure requirements, it is not as if Mr. Elgart was intimately, or even slightly, familiar with Question 14M. To cite to Mr. Elgart's long tenure in the securities industry as proof that his professed ignorance of the nuances of Form U-4 is not credible is to ignore unrebutted facts that clearly establish his tenure simply failed to provide him with the opportunity to become more than passingly acquainted with Form U-4.

FINRA also argues that Mr. Elgart cannot rely on the fact that he delegated responsibility for U-4 amendments to the FINOP because the FINOP would not have known about Mr. Elgart's liens, and therefore could not have known to disclose them. That misses the point of Mr. Elgart's argument entirely.

The point is that FINRA concluded Mr. Elgart was supposedly not credible because he had 45 years in the securities industry, and that in those 45 years he undoubtedly *had* to have become familiar with Form U-4; thus, when he testified that he was not familiar with Form U-4, he was not credible. But, that lack of familiarity makes sense in light of Mr. Elgart's delegation to the FINOP. Accordingly, Mr. Elgart's delegation of U-4 responsibilities supports his testimony that he simply misunderstood Question 14M, and the fact that Mr. Elgart did not advise the FINOP of the liens is consistent with that misunderstanding (inasmuch as he did not understand his personal liens required disclosure).

2. + FINRA's Argument That Mr. Elgart "Repeatedly" Failed To Update His Form U-4 Is Misleading And Specious.

In another attempt to discredit Mr. Elgart, FINRA argues that he "repeatedly failed to amend" his Form U-4 13 times. FINRA's Response at p. 16, n. 9. Again, it may be true that Mr. Elgart amended his Form U-4 13 times after a tax lien was first imposed on him, but it is *not* true that this serves as evidence that his testimony that he misunderstood Question 14M was not

credible. The evidence in the record showed that these U-4 amendments were to change an address, or to make a change to a registration status. There is absolutely nothing in the record that establishes that when these amendments were filed, either Mr. Elgart or the FINOP delegated with the responsibility for filing the U-4 either read or considered any of the substantive questions on the form. All prior answers on Form U-4 simply auto-populate when an amendment is filed. Thus, if Mr. Elgart had an existing "no" answer to Question 14M, and then subsequently amended his Form U-4 to reflect a change in address, that "no" would be carried forward, automatically, without doing anything. FINRA's argument suggests that there was some conscious thought – 13 times – to keep the answer to Question 14M "no." That is false. It is unsupported by the record and FINRA knows better.

3.0 Mr. Elgart Did Not Provide Inconsistent Versions Of The Dates Pertinent To The Undisclosed Liens.

FINRA's final argument why Mr. Elgart should not be deemed credible when he says that he misunderstood Question 14M is that he supposedly gave "numerous inconsistent explanations of when he became aware of the tax liens." FINRA's Response at p. 22. This argument is belied by the record evidence.

Mr. Elgart testified at hearing that he learned of the liens around the time they were issued, and turned them over to his accountant and tax attorney.[8] This testimony was corroborated by the correspondence he exchanged with FINRA representatives during the examination that, ultimately, led to the issuance of the Complaint.[9]

[8] Record at Bates No. 478 (Elgart testimony).

[9] Record at Bates No. 1054 (RX-19).

> While he cannot recall an exact date, Mr. Elgart believes that he became aware of the liens on or around the time they were filed. As he has advised previously, his non-disclosure of those liens on his Form U-4 was not the result of a failure to detect them, but, rather, misunderstanding of his reporting obligations.

Thus, as to when Mr. Elgart learned of the liens, the record is clear and without contradiction.

Mr. Elgart was also consistent in his testimony regarding when he learned that the liens constituted required disclosures on his Form U-4. He testified that he first learned the liens were required disclosure items when FINRA staff explained to him the meaning of Question 14M during its examination.[10] This testimony was corroborated by Mr. Cormier, the FINRA examiner. He told the Hearing Panel that during his discussions with Mr. Elgart, *at the precise time* he made Mr. Elgart aware of his error, Mr. Elgart responded that "he overlooked this inadvertently, it was a mistake and that he was in no way trying to mislead [FINRA]."[11]

Later in the FINRA exam, Mr. Elgart provided an utterly consistent written statement to the FINRA staff.[12]

> Unfortunately, ...I was simply not aware of my need to update my U-4 for such situations of the liens.... In short, this update was inadvertently overlooked and was a mistake, but was by no means and in no way done to obfuscate this information, i.e. the outstanding liens....
>
> I always thought that FINRA's direct attention as well as my own was anything that impairs Sequoia Investments and its clients directly.

Later still, in correspondence Mr. Elgart sent through counsel,[13] he repeated this same sentiment:

> While [Mr. Elgart] understood that he was required to make certain disclosures under certain circumstances, he believed that disclosable events related to clients, firm investments, or disciplinary activity. He was simply unaware that a pending tax lien filed against him personally was a required disclosure. The non-disclosure was not an attempt to conceal the information from either FINRA or his clients; it was simply a mistake.

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[10] Record at Bates Nos. 495-501 (Elgart testimony). *See also* Record at Bates Nos. 442,446-447, 793, and 831.

[11] Record at Bates No. 460 (Elgart testimony).

[12] Record at Bates Nos. 1043-1044 (RX-13).

[13] Record at Bates No. 1054 (RX-19, p. 2).

In short, contrary to FINRA's argument, as well as the findings in the Decision, not only was Mr. Elgart's testimony on this point clear, it was (1) consistent, (2) corroborated in writing, and (3) corroborated by FINRA's own witness.

In light of this, FINRA is forced to make a big deal about the date listed on Mr. Elgart's amended Form U-4 – January 1, 2013 – as the date he learned of the liens. But, Mr. Elgart's testimony on that subject reveals that he was not being "inconsistent," and, thus, not credible; rather, he was simply attempting to be as honest as possible.

When Mr. Elgart amended his Form U-4 to disclose the liens, following his conversations with FINRA staff, Question 14M required him to state when he learned of the liens. Mr. Elgart supplied the date he recalled talking to his attorney and learning (1) the total number of liens, and (2) their combined value.[14] Mr. Elgart testified that conversation occurred around January 1, 2013, and explained[15]:

> Q. Why did you pick that January 1st date?
>
> A. That was basically the first meeting we had with Ray Buchanan. In fact, Ray Buchanan connected us with Scott McHugh who was not my accountant prior to that, and Scott McHugh became the accountant of record in 2013 and so did Ray Buchanan.
>
> ***
>
> Q. Do you recall why you talked with him in January of 2013?
>
> A. Yes. We were getting letters from the IRS, I was going to visit my son out of state, and as a consequence I called an attorney of mine and said I need someone to help me with all of this. We had been dealing with the IRS and this question of taxability of return of capital versus ordinary income or withdrawal of money from the firm when we split the firm with Mr. Winer.
>
> I finally decided to engage an attorney instead of trying to do it myself. That was at the end of 2012 or toward the end of 2012. So that's when we retained him and that's when he took – got all of the notices and informed me of how many actual

[14] Record at Bates No. 1001 (JX-003), and Bates Nos. 513-515 (Elgart testimony).

[15] *Id.*

> liens there were. I think I chose the first. It might have been the last two days of 2012. I think just for accuracy sake when we came back and we had our first meeting with Ray Buchanan I think was 2013.

Once, again, the testimony is unrebutted and without contradiction.

Mr. Elgart's testimony was consistent, not only during the hearing but throughout the examination as well. Accordingly, FINRA's ruling as to Mr. Elgart's credibility was in error, and should be reversed.

C. FINRA's Precedent On "Willfulness" Is Unfairly Vague.

FINRA does not dispute that in its prior decisions and settlements, it has provided people like Mr. Elgart with a jumbled and inconsistent approach to answering the question whether someone's conduct was willful or not. Rather, as it did with its effort to dismiss *Harris* merely as meaningless drivel coming from a misguided hearing panel, FINRA instead says that there is no problem here because we should all simply ignore any troublesome cases that appear to be outliers because – once again – they "have no precedential value and do not serve as a guide to the meaning of 'willfully.'" FINRA's Response at pp. 27-28. So, to recap, hearing panel decisions have no precedential value. Similarly, FINRA settlements have no precedential value. We are to pretend here that they do not exist, presumably.

But, if hearing panel decisions and settlements have no meaning for anyone other than the actual respondents in those actions, why, then, does FINRA bother to publish them all on its website? Why does it issue a monthly report summarizing them all and provide that report to each of its member firms? It does so because it knows very well that both its hearing panel decisions and settlements are used as signals to the industry, so others can learn lessons from them. Indeed, FINRA's own Sanction Guidelines make explicit that FINRA's Enforcement process is designed to be a tool for *all members*, not just the particular respondents: "Adjudicators should design sanctions that are meaningful and significant enough to prevent and

discourage future misconduct by a respondent ***and deter others*** from engaging in similar misconduct."[16] FINRA expressly intends that its members read – and learn from – *any* Enforcement matter that includes the imposition of sanctions, including both hearing panel decisions and settlements.

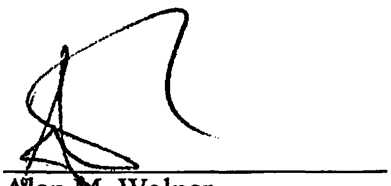
Accordin , it is a flimsy argument, at best, for FINRA to tout its "broad prosecutorial discretion" as the reason we should all simply ignore prior Enforcement matters that include language that may be less than helpful to FINRA's present case. Mr. Elgart, as a member of the FINRA community, is entitled to rely on the guidance that FINRA produces, no matter its particular source. And sadly, at least here, that guidance was muddy. And that makes it unfair.

II. CONCLUSION

For the reasons stated herein, the Commission should: (1) vacate the finding that Mr. Elgart acted willfully; (2) reduce the fine for his U-4 violation to something not to exceed $2,500; (3) eliminate the suspension for his U-4 violation; (4) vacate the finding that Mr. Elgart acted in bad faith by responding to the FINRA questionnaire; and (5) reduce the sanction for the FINRA questionnaire error to a Cautionary Action Letter.

Dated: July 28, 2017

ULMER & BERNE LLP



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[16] FINRA's Sanction Guidelines at p. 2 (emphasis supplied).

CERTIFICATE OF SERVICE

I hereby certify that on July 28, 2017, I served a copy of the foregoing **APPLICANT'S REPLY BRIEF IN FURTHER SUPPORT OF PETITION FOR REVIEW**, as follows:

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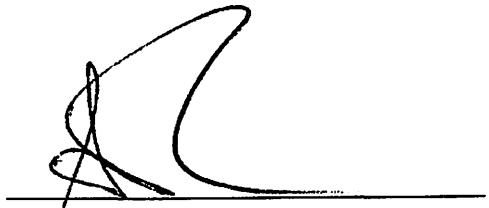

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