BEFORE THE
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC

In the Matter of the Application of

William H. Murphy & Co., Inc. and William H. Murphy

For Review of Disciplinary Action Taken by

FINRA

Administrative Proceeding File No. 3-18895

FINRA'S BRIEF IN OPPOSITION TO APPLICATION FOR REVIEW

Alan Lawhead
Vice President and
Director – Appellate Group

Jennifer Brooks
Associate General Counsel

Lisa Jones Toms
Assistant General Counsel

FINRA
1735 K Street, NW
Washington, DC 20006
(202) 728-8044 Telephone

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I. INTRODUCTION

This case involves the sales of unregistered securities over the course of 22 months. From March 2011 to January 2013, William H. Murphy & Co., Inc. ("WHM"), acting through its president, William H. Murphy ("Murphy") (together "Applicants"), unlawfully sold over $1 million in unregistered securities in three private fund offerings with no registration statement filed or in effect and no available exemption from the Section 5 registration requirements. The private fund offerings were purportedly sold pursuant to Regulation D, Rule 506, which prohibits the offer and sale of securities by general solicitation.

WHM violated the ban on general solicitation when, through its registered representatives, WHM hosted radio programs and conducted workshops to solicit potential investors to buy the private fund securities. The radio programs aroused interest in the offerings by promoting private placements as the alternative investment to the traditional stock market and encouraging listeners to attend a workshop to learn about "passively" investing in multi-family real estate. The workshops touted the benefits of private placements as investments and

encouraged potential investors to meet with a WHM representative to determine their qualifications to invest in the private funds. Because WHM had not established a substantive relationship with the investors before it solicited prospective investors, the radio programs and workshops constituted *offers* of securities through general solicitation. By acting in contravention of Section 5 of the Securities Act of 1933, WHM violated FINRA's just and equitable principles of trade rule.

The record also fully supports FINRA's findings that WHM and Murphy failed to take reasonable supervisory steps to avoid the unlawful sales. Rather than establishing a compliance system designed to supervise reasonably the private fund sales, WHM, through Murphy, ignored obvious red flags signaling violative conduct. The Applicants further failed to provide its representatives with effective training or written procedures to ensure that WHM's unregistered sales complied with the federal securities laws and FINRA's rules.

The Commission should follow well established case precedent and affirm the National Adjudicatory Council's ("NAC's") findings and sanctions in its entirety.

II. FACTUAL BACKGROUND

A. The Applicants

WHM was a broker-dealer in Houston, Texas.[1] RP 8, 127, 713, 837, 8097-99, 13967. The firm had 19 non-registered locations, 25 registered representatives, and two offices of supervisory jurisdiction ("OSJ"), one of which was located at the office of Liberty Real Estate Advisors ("LREA"), a limited liability company based in Houston, Texas. RP 8, 127, 713, 837, 8097-99, 13967.

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[1] References to "RP" are to the pages in the certified record filed by FINRA in this matter.

Murphy founded WHM in 1990, was the firm's acting president, director, chief compliance officer, and served in several registered capacities.[2] RP 9, 713, 838, 7150, 8073-88, 8094, 13968, 14818. Murphy was also responsible for the supervision of WHM's private placement activities, all associated persons, and OSJ branch offices. RP 713, 13968, 14818. Both WHM and Murphy have terminated their FINRA registrations since August 2018. RP 14818.

B. LREA

LREA is a non-registered startup business. RP 9, 128, 175, 248, 14819. Trey Stone ("Stone") is its owner and chief executive officer. RP 9, 13974, 14819 n.3. Stone formed LREA to "launch a successful media campaign to market its services to potential clients" and "introduce pre-qualified and suitable clients to associated issuers of private placements." RP 11985, 12149, 14819. LREA had three affiliated companies—the 2011 Guardian Equity Fund, LLC ("GEF"), the 2012 Multi-Family Real Estate Fund II, LLC ("MFREF2"), and the 2012 Multi-Family Real Estate Fund III, LLC ("MFREF3")—that issued LLC member interests through private offerings ("Affiliated Private Offerings").[3] RP 11-13, 129, 251, 10308, 12057, 13969, 14819.

C. LREA Partnered with WHM to Solicit Sales in Unregistered Securities

In April 2010, LREA applied to FINRA to become a registered broker-dealer with the intention of selling the Affiliated Private Offerings on its own. RP 6042, 13970, 14378, 14819. Due to the lack of experience in selling private placements, however, LREA withdrew its new

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[2] At WHM, Murphy was registered as a general securities representative, a general securities principal, a municipal securities representative, a municipal securities principal, an investment banking representative, and an operations professional. RP 8076.

[3] Stone was the president of GEF, MFREF2, and MFREF3, and managed the affiliated companies through his managing company, Guardian Equity Management, L.L.C. RP 714, 6209, 12149, 13974.

membership application and sought an arrangement with WHM to sell the Affiliated Private Offerings on its behalf. RP 13970, 14379, 14819.

In March 2011, LREA entered into an arrangement with WHM ("OSJ Agreement"), whereby WHM established an OSJ at LREA's office ("LREA OSJ") and sponsored LREA employees as associated persons of the firm to "engage in the solicitation, purchase, and[/]or sale of securities" under WHM's direction. RP 8251-66, 10308, 13970-72, 14820. WHM and LREA also entered into a Joint Client Services Agreement, under which WHM handled all securities-related activities, including "investor solicitation," "sales activities," and "transaction negotiations."[4] RP 10325-32, 13971-72, 14820 n.4. WHM also had a selling agreement with each issuer GEF, MFREF2, and MFREF3 by which WHM served as the exclusive placement agent for the offerings and received a one percent commission for each sale.[5] RP 12067, 12331-13482, 14820.

WHM solicited sales in the Affiliated Private Offerings primarily through two registered representatives at WHM who were also LREA salaried employees. RP 9-10, 175-76, 13974-75, 14820. LREA hired Mindy M. Price in April 2010 April 2010 as its vice president of business development and she was registered with WHM as a representative from March 2011 to August 2012. RP 839, 8105. Before LREA, Price had no previous securities experience. RP 8101-08,

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[4] Around February 2013 and during FINRA's investigation, WHM's counsel created an Amended Joint Client Services Agreement, which Murphy signed but left it undated. RP 10453-58. The Amended Joint Client Services Agreement kept the effective date of the original Joint Client Service Agreement (March 15, 2011) but substantially changed provisions related to LREA's business by removing any language that suggested LREA would offer securities to investors and limiting LREA's stated business activities to "educational and networking services." RP 10454.

[5] LREA additionally paid WHM a non-refundable retainer fee for providing compliance services at LREA, which totaled $54,980.86 and was paid "regardless of whether [WHM] market[ed] any securities issued by affiliates of LREA." RP 714, 7166, 8264, 13971.

11986, 12003-05. At LREA, Price hosted LREA radio shows and held workshops used by WHM to generate investor interest in the Affiliated Private Offerings, conducted one-on-one meetings for those interested investors, and qualified prospective investors by having them complete WHM new customer account forms. RP 9-10, 714, 6058, 6085, 6094-95, 14820.

Mark C. Hutton was also a dual WHM representative and LREA employee. RP 715, 839, 8114, 13976, 14820. Hutton had some securities experience, but less than one year's experience in supervising private placement sales. RP 8112-13, 12007-08. Nevertheless, WHM designated him as the OSJ principal responsible for the "supervision, purchase, and or sales activities of any WHM registered representative" who was located at LREA. RP 6732, 8253. In this role, Hutton monitored the LREA radio shows and workshops, reviewed and approved the new customer account forms, and conducted suitability reviews of the potential investors who met with Price one-on-one. RP 135, 6741, 6744, 13975, 14826. After Price left the firm, Hutton assumed Price's duties of meeting with potential investors who attended the LREA workshops and qualifying them for investing in the Affiliated Private Offerings. RP 6736, 10471, 13975-76, 14826.

Price and Hutton earned selling commissions from WHM for each sale made in the Affiliated Private Offerings. RP 10, 176, 6085, 6214, 10471, 13975-76, 14820.

D. WHM Sold Unregistered Securities

From March 2011 to January 2013 ("Sales Period"), WHM participated in the sale of interests in GEF, MFREF2, and MFREF3 that raised capital to purchase multi-family real estate properties. RP 7, 174, 14818. Each offering's confidential private placement memorandum ("PPM") stated that the interests were not registered under applicable federal securities laws and

offered pursuant to Regulation D, Rule 506 and Section 4(2) of the Securities Act. RP 8855-9114, 12055-322, 12795-13000.

For twenty two consecutive months, WHM induced hundreds of radio listeners to attend a workshop and learn about investing in private placements and multi-family real estate opportunities. RP 13, 175-76, 718, 839, 1397, 11994-95, 13975, 13977, 14822-23. Twenty-three LREA workshop attendees became WHM customers and purchased $1,031,700 worth of the affiliated fund securities. RP 8, 419, 6082, 13979, 13983. Of the 23 fund investors, 10 of them were non-accredited. RP 11055. For all the unregistered sales, WHM was compensated with $23,230.05 in sales commissions.[6] RP 11-12, 716, 720, 7164, 7438-39, 10303, 12056.

A breakdown of the unregistered sales for each Affiliated Private Offering during the Sales Period is as follows:

- From June 15, 2011, through May 31, 2012, the GEF private offering raised $1,428,775 from 26 investors—11 of whom were WHM customers that, through LREA's radio shows and workshops, purchased $545,200 in LLC member interests. RP 419, 716, 12055, 13969, 14821. For its sales, WHM received $14,287.75 in commissions. RP 13984, 14821.

- From May 9, 2012, through May 31, 2013, the MFREF2 private offering raised $1,550,488 from 43 investors. RP 11, 716, 13969, 14821. Eight of those investors were WHM customers that, through LREA's radio shows and workshops, purchased $235,000 in LLC member interests. For these transactions, WHM received $3,845.30 in commissions. RP 13985, 14821.

- From September 21, 2012, through September 20, 2013, the MFREF3 private offering raised over $1.7 million from 39 investors. RP 12, 716, 13985, 14821. Four of those investors were WHM customers that, through LREA's radio shows and

[6] Price and Hutton received a portion of the sales commissions that WHM earned. RP 6710, 6735, 12149.

workshops, purchased $251,500 in LLC member interests, for which WHM received $5,097 in commissions. RP 13985, 14821.

E. WHM Representatives Solicited Potential Investors Through Radio Broadcasts and Workshops

LREA's marketing strategy used local public advertising, including radio broadcasts, commercials, and workshops to promote multi-family real estate investing and seek potential buyers in the Affiliated Private Offerings. RP 11983-12016, 13976, 14379, 14822. WHM, through its registered representatives, used the LREA radio shows and workshops to generate the 23 investors, who it signed up as customers and sold the Affiliated Private Offerings. RP 7327, 14822.

1. The LREA Radio Shows

For the 23 WHM investors, the LREA radio shows initiated the process that led each person to become a WHM customer. RP 13, 717 n.7, 1397, 6113, 13977. The LREA radio talk shows were "aired to the general public and focused on real estate as an investment vehicle" and "feature[d] strategies for participants struggling to find alternatives to the stock market who lack[ed] expertise in real estate or desire[d] to enhance their expertise." RP 11994. The radio shows were: (1) broadcast over the airways,[7] (2) placed on LREA's unrestricted, publicly accessible website as podcasts,[8] and (3) sent to potential investors via email as podcast links.[9]

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[7] During the Sales Period, LREA broadcast its radio shows on stations in the Houston, Texas and Sacramento Valley, California markets, including 700 AM-KSEV, Business 1110 AM, and Talk 650 AM. RP 6104. LREA radio commercials were also broadcast over the airways. RP 6174-75, 6189-91, 13579.

[8] RP 6117, 6119, 6248, 9282.

[9] RP 11995, 13978.

Price primarily hosted the LREA radio programs, which ranged from general real estate topics, to more targeted discussions about multi-family real estate investments, including whether investing passively in multi-family real estate through a private placement was something that the listener could add to their portfolio. RP 9253-9412.

On the radio, Price and others spoke in detail about private placement investing, using securities investment terminology and securities-related catchphrases as inducements, including:

- diversify your investment portfolio;[10]
- adding multi-family real estate investments to the listener's portfolio;[11]
- good time to invest in apartments;
- passive investments;[12]
- private placements as an offering available to private investors;[13] and
- free workshops provided by LREA that listeners could attend to learn more about investing in real estate.[14]

Although Price did not mention the Affiliated Private Offerings specifically on the radio, she discussed what a private placement and an "accredited investor" were, and how investing in private placements was "another thing" that "now everybody can actually get involved with." RP 9282-84. Price urged the listeners to look for alternatives to traditional investments and "consider adding multifamily real estate to their portfolio." RP 9256, 9260, 9264. Price also

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10 RP 9254.

11 RP 9264, 9275.

12 RP 9279.

13 RP 9282.

14 RP 9381.

touted her own investment in the GEF offering, remarking how great it was to purchase an apartment complex as an investor in "the La Estancia deal," i.e., a multi-family property that GEF acquired. RP 6459-60, 13978, 13984.

Throughout the radio shows, Price repeatedly encouraged listeners to attend a free LREA workshop to learn more about multi-family real estate investment opportunities. RP 839, 9288. LREA also aired weekly radio commercials, enticing the public to attend the workshops and learn more about "a lucrative trend" to "look at what's in your portfolio" and to "buy low and sell high, right now apartments are low." RP 6189-91, 6303-04, 9415, 13979.

Hutton testified that, while one purpose of the LREA radio shows was to urge the listeners to attend the LREA workshop, the other purpose was to "generate interest in passive investing and multi-family real estate." RP 6778-79. During the Sales Period, 261 individuals who listened to the radio shows subsequently attended the LREA workshops. RP 14, 418, 719, 14823.

2. The LREA Workshops

The LREA workshops identified prospective purchasers for the Affiliated Private Offerings.[15] Price followed detailed scripts that Murphy reviewed and approved[16] and discussed

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[15] *See* RP 6789-90 (Hutton admitting that, as a LREA service, the workshops were conducted to "find investors for private placements offered by [LREA]'s affiliated funds").

[16] The Applicants claim the scripts had changed "when the business model change to education only." Br. 11. Their claim is unfounded. For example, although Price testified at the hearing that the Introductory Workshop script, JX-67, was an old document that "never went live," RP 6130-31, 6133, Murphy admitted that he approved it. RP 7283. The Hearing Panel concluded that Price used the Introductory Workshop script because her testimony of what she covered in the LREA workshops matched the content of the script. RP 6137-38, 13980 n.127. WHM and Murphy also inaccurately claimed that Enforcement's exhibit CX-27, the Quick Start presentation, never went live. RP 6800-02. However, a comparison of Enforcement's exhibit compared with the Applicants' proposed exhibit of the *final* Quick Start presentation, RX-93, revealed that the two exhibits were identical. RP 6803-04, 13980, 14824.

investing in private placements, including what private placements were, the regulatory limitations on non-accredited investors permitted to invest, and how a workshop attendee could qualify to invest in them. RP 7279, 7283-84, 13980.

Price used the LREA workshops to promote passively investing in multi-family real estate. Based on the "Introductory Workshop" script, Price aimed to educate workshop attendees on an "alternative to your traditional 401(k) and IRA investments like stocks, bonds, and mutual funds." RP 13545. Price's opening remarks at the Introductory Workshop stated, "Our sales pitch by asking you to listen to this workshop is this . . . we have come up with an investment vehicle that has allowed many investors to achieve returns that can exceed what your more traditional forms of investing have typically been able to deliver." RP 13549. She explained that LREA's real estate investing focus was multi-family housing—the same properties that GEF, MFREF2, and MFREF3 were acquiring. RP 13545. Price offered to teach "investors" about various aspects of real estate investing, including "how [the attendee] can get involved through private placement offerings." RP 13509. Price further explained that, upon meeting with a broker representative, attendees would learn more about "private placements and issuers who are doing deals here in the Houston market." RP 13558.

Similar to the Introductory Workshop script, the LREA "Quick Start" presentation encouraged attendees to invest in the Affiliated Private Offerings by referencing "real estate investing," "building streams of passive income," and LREA's "affiliate company" that "puts together single family flips and multi-family opportunities with a team of industry professionals," and asked the attendees "[a]re these type of investments right for you." RP 8281-92.

During a scripted speech given at "The Real Estate Investor Main Event," a LREA executive vice president remarked on how LREA makes money despite offering free workshops, stating:

> Liberty Real Estate Advisors provides free education. There is an affiliate company that offers multi-family opportunities for those who are deemed suitable by our 3rd party broker-dealer, William H. Murphy. If you would like to learn more, please see any of our Liberty employees to set up a time.

RP 13588.[17]

At the end of the LREA workshops, attendees were given the opportunity, if interested, to speak with a WHM representative about investing in LREA's affiliated offerings.[18] RP 719, 6174, 13981, 14825.

3. Tracking the Success of LREA's Marketing Efforts

LREA tracked the success of its marketing campaign by having workshop attendees complete a "Contact Information" form. *See, e.g.*, RP 719, 6174, 12371, 13981, 14825. The form stated that WHM was conducting securities transactions and requested the attendee's contact information, the date of the workshop, how the attendee heard about LREA, and whether the attendee wanted "additional information" about the Affiliated Private Offerings. *See, e.g.*,

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[17] The LREA executive further remarked, "If you have $50,000 or more of investable capital we recommend speaking with a registered rep of our 3rd party broker-dealer to see if multi-family is suitable for you." RP 13589.

[18] All LREA public communications included disclosure statements that indicated to the general public that listeners and workshop attendees, if interested, could purchase securities from WHM, a broker-dealer connected to LREA. For example, the radio show disclaimer stated, "Securities sold through William H. Murphy and Company, Incorporated, a registered broker-dealer, member FINRA and SIPC." RP 9289, 9361. The workshop disclaimer stated, "Securities transactions are conducted by certain employees of Liberty Real Estate Advisors, LLC that are also registered through Wm. H. Murphy & Co., Inc., Member FINRA/SIPC." RP 8149-50.

RP 12371, 13981, 14825. The form did not collect the attendee's financial information and Murphy prohibited Price and Hutton from asking about their securities or investment experience at the workshops. RP 720, 6153, 6171, 6173, 7263, 13981, 14380.

LREA also tracked information about the workshop attendees in a database to determine which marketing methods produced an "ideal client." RP 9521-26. The tracking system was purely focused on an attendee's interest in investing in securities, rather than real estate education. Br. 10. LREA used metrics such as, "Investment Amount," "Accredited [or] Non-Accredited," net worth, and the source of LREA's marketing, to identify the ideal client. RP 9525-26. Despite WHM's claim that LREA's primary service was to educate the general public about real estate, its "ideal client" spreadsheet contained no metrics on education-related information.[19]

F. WHM Formed A Substantive Relationship Only *After* It Solicited the General Public

WHM had no pre-existing substantive relationship with any of the 23 investors before they listened to a LREA radio program or attended a LREA workshop. RP 14, 13983, 14833. During the Sales Period, 34 LREA workshop attendees met either with Price or Hutton one-on-one at the LREA OSJ to learn more about private placement investments. RP 14, 418, 719, 7114-15, 13981, 14825. Price or Hutton, as a WHM representative, discussed the prospective customer's real estate experience, investment experience, and other financial matters to gauge their level of sophistication and determine whether they were an accredited investor. RP 134, 6178-80, 14381, 14825. Price or Hutton then gave the attendee a WHM new customer account

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[19] LREA also created monthly "pipeline" spreadsheets that LREA, WHM, and the affiliated issuers utilized to project which workshop attendee would invest in the MFREF2 and MFREF3 offerings based on their one-on-one meetings with Price. RP 10291-94.

form to complete, which requested information about their financial status and investment experience. *See, e.g.*, RP 12374-79. Completion of the new customer account form was the first time WHM obtained financial information about a prospective investor in order to form a substantive relationship. RP 134, 720, 6703.

Being a new WHM customer, however, was incidental to an investor buying unregistered securities in the affiliated offering.[20] Potential investors were initially qualified by Price, who reviewed the customer account forms and conducted an initial suitability review. Hutton, in his capacity as the OSJ principal, determined suitability and approved the customer as an investor.[21] RP 720. Murphy, however, ultimately approved all WHM new account forms. RP 135-36, 13987. WHM offered the Affiliated Private Offerings only to customers who attended the LREA workshops and not existing firm customers. RP 7168-69, 7327.

G. WHM's and Murphy's Supervision of the LREA OSJ

As WHM's president, Murphy was responsible for establishing and maintaining WHM's supervisory system, including its Written Supervisory Procedures ("WSPs"). Murphy accepted customer accounts and supervised all WHM associated persons, advertising, and private placement activities. RP 7222-23, 7225, 11705, 11761. Although Murphy assigned Hutton

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[20] Contrary to its unfounded suggestion, WHM did not publicly advertise itself as a broker-dealer on the radio or at the LREA workshops solely to obtain new clientele for the firm. *See* Br. 8, 15 (stating "A broker dealer can publicly solicit new clients."). Per the selling agreements, GEF, MFREF2, and MFREF3 retained WHM during the Sales Period as their exclusive selling agent to use "[its] best efforts to locate for the account of the Company *and not for [its] own account* a limited number of investors to purchase Interests pursuant to this Offering." RP 13476 (emphasis added).

[21] WHM's financial and operations professional, Michael Schaps, also reviewed new account documentation provided by Price or Hutton. RP 135, 7739, 13987. Schaps admitted at the hearing, however, that he never listened to the LREA radio shows, never attended a LREA workshop, and never visited the LREA OSJ. RP 7844, 7848.

registered principal duties at the LREA OSJ, Murphy was ultimately responsible for its supervision. RP 7112, 7209, 13987, 14003. During the Sales Period, Murphy had not delegated his supervisory functions at LREA, which included approving radio show content, workshop scripts, videos, and other advertisements. RP 7222-25, 13979, 14003. Murphy also supervised WHM's sales in the Affiliated Private Offerings, giving the final approval to accept new customers who then invested in the offerings. RP 7351.

WHM and Murphy had no procedures and controls to market and sell the Affiliated Private Offerings in compliance with Securities Act Section 5. When WHM extended its business and established LREA as an OSJ branch of the firm, it failed to establish written procedures to address that business activity. The WSPs did not address WHM's arrangement with LREA or any of the issuers, and its supervisory control procedures did not recognize the LREA location as an OSJ.[22] RP 11693-962, 13988.

There were no WSPs requiring a supervisory principal to verify compliance with Regulation D or any relied upon exemption from registration before WHM's participation in the unregistered offerings commenced. No written procedures existed to comply with the general solicitation prohibition, including ensuring that new WHM customers from the LREA radio shows and workshops did not purchase securities of live offerings open for sale without first establishing a substantive relationship. RP 7078-79. WHM and Murphy purportedly utilized a 30-day "cooling off" period before sales in the Affiliated Private Offerings were made, but WHM had no documented procedures establishing when that period began or ended. RP 6754.

Murphy also failed to supervise the LREA OSJ, its registered persons, and its sales activities. Murphy conducted one annual examination of the OSJ at LREA, but he never

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[22] The WSPs also failed to detail the compliance functions that WHM provided to LREA.

conducted a formal branch review. RP 7287. He scantly reviewed LREA's website and could not recall reviewing LREA's videos and podcasts. RP 7309-11. Instead of documenting his discussions or meetings regarding Section 5 compliance, in particular the public marketing for unregistered sales of securities, Murphy denied that WHM was selling private placements.

Murphy did not reasonably supervise Price and Hutton. Hutton had less than one year's experience of supervising private placements and, before LREA, Price had no prior securities experience. RP 8112-13, 8103. Despite this, Murphy only gave verbal instructions to Hutton and Price regarding selling unregistered securities by general solicitation, and verbal instructions to Hutton regarding his OSJ designated principal duties. RP 7237-38. For example, at the LREA radio shows and workshops, Price and Hutton testified that they had to make sure they did not mention the Affiliated Private Offerings by issuer name or use the term "securities." RP 7237-39. Yet, Murphy provided no formal training on the types of public communications that could constitute a general solicitation under SEC Rule 502(c).

Despite Price's limited securities experience, Murphy testified that he was not concerned about Price essentially handling the one-on-one meetings on her own. RP 7273. There were no procedures or controls on the nature and content of discussions at the one-on-one meetings. Although Price conducted the initial meetings to determine if a prospective WHM customer was qualified to invest in the offerings, Price testified that she never had read—much less referenced—the PPMs of the affiliated offerings. RP 6196. Price did, however, mention the issuers of the Affiliated Private Offerings, while never having seen or read the PPMs, except her own. RP 6196, 6316-17, 6320.

WHM and Murphy also failed to detect and investigate red flags regarding LREA's public advertising. Murphy testified at the hearing that one of his "original red flags" was

having WHM registered representatives "doing the video shows and the workshops" with an interest towards qualifying customers to invest in the Affiliated Private Offerings. RP 7173. Yet Murphy repeatedly approved scripts and other LREA communications that encouraged the general public on the radio and at workshops to invest in currently offered multi-family real estate private placements. Hutton had no written supervisory guidelines to detect and address red flags when monitoring the LREA radio shows, workshops, or private placement sales. RP 6732-53, 7236-37. At the hearing, Hutton only pointed to a generic section in the WSPs stating that WHM would hold meetings to "discuss thoroughly the nature of any security or underwriting or offering in which the Company participates." RP 6752, 11843.

III. PROCEDURAL BACKGROUND

On November 7, 2014, FINRA's Department of Enforcement ("Enforcement") filed a two-cause complaint. RP 1-24. The first cause alleged that WHM participated in sales of GEF, MFREF2, and MFREF3 that were neither registered nor exempt from registration, in contravention of Section 5 of the Securities Act, and in violation of FINRA Rule 2010. RP 18. The second cause alleged that WHM, acting through Murphy, failed to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to ensure compliance with Section 5 of the Securities Act, in violation of NASD Rule 3010 and FINRA Rule 2010. RP 19.

A FINRA Hearing Panel found that WHM "engaged in unregistered sales of more than $1 million of securities to 23 customers, in violation of Section 5 of the Securities Act," and that, because the securities were sold by general solicitation, WHM "failed to prove that an exception to the registration requirement existed." RP 14001. It further found that WHM and Murphy violated NASD Rule 3010 and FINRA Rule 2010 by "failing to establish and maintain a

supervisory system, including WSPs, reasonably designed to ensure compliance with Section 5." RP 14003-04. The Hearing Panel fined WHM $50,000 and ordered that it disgorge $78,210.91, for its unlawful unregistered sales. RP 14009. For their inadequate supervision, the Hearing Panel fined WHM and Murphy $50,000 each, suspended Murphy from associating with any FINRA member for six months, and required Murphy's requalification by examination. RP 14009.

On appeal, the NAC affirmed the findings of violation. RP 14815-50. The NAC fully considered the record and the arguments of the parties. The NAC disagreed with WHM's assertion that because the LREA radio shows and workshops did not name the Affiliated Private Offerings or mention specific securities, the communications were not general solicitations. RP 14833-34. In addition, the NAC rejected the firm's argument that, because LREA's business included educational and networking components, WHM's use of LREA's radio programs and workshops to attract potential investors in the Affiliated Private Offerings was not a general solicitation. RP 14834. The NAC further found no legal authority to support WHM's position that a general solicitation could be cured once there is a cooling off period after the general solicitation but before the investor purchases the offering. RP 14836. Lastly, the NAC found that WHM's and Murphy's supervisory system and procedures governing the LREA-related activities were not reasonably designed to prevent WHM's unregistered, non-exempt sales in the Affiliated Private Offerings. RP 14837-39.

For WHM's unregistered securities sales, the NAC found myriad aggravating factors and no mitigating factors and affirmed the $50,000 fine. RP 14846. The NAC reduced the disgorgement amount to $23,230.05 to align with WHM's unlawful commissions earned from its wrongdoing. RP 14847-48. The NAC found that the supervisory failures in this case were

extensive, but determined that a joint and several fine between WHM and Murphy was appropriate given that WHM was a smaller firm and WHM's and Murphy's supervisory obligations were intertwined. RP 14849. The NAC therefore fined WHM and Murphy $50,000, jointly and severally, and affirmed Murphy's six-month suspension and requalification by examination in all capacities. RP 14848-49. This appeal followed.

IV. ARGUMENT

The Commission should dismiss WHM's and Murphy's application for review. The record overwhelmingly supports the NAC's findings that WHM sold unregistered securities without an available exemption in contravention of Section 5 of the Securities Act. Enforcement established a prima facie case that WHM offered and sold securities in the Affiliated Private Offerings by interstate means without a registration statement filed or in effect. WHM, on the other hand, did not prove that the Regulation D exemption upon which it purportedly relied was available when it offered and sold the Affiliated Private Offerings.

To rely on the safe harbor provisions under Regulation D, Rule 506, WHM was prohibited under SEC Rule 502(c) from making an offer or sale of an unregistered security by general solicitation. Ignoring these requirements, WHM had registered representatives publicly host radio shows and conduct workshops using targeted sales pitches to attract potential investors in purchasing the private offerings. The LREA radio broadcasts and workshops are the exact methods of public communication prohibited under the general solicitation rule. The LREA radio shows and workshops were unrestricted solicitations that constituted offers to buy securities and WHM was required to preserve the Rule 506 exemption throughout the entire selling process.

The record also establishes that WHM and Murphy failed to establish and maintain a supervisory system for the LREA sales activities. Murphy had ultimate responsibly for maintaining the firm's WSPs and supervising all the private placements that WHM sold. Murphy, however, failed to revise the WSPs to provide adequate procedures and controls to reasonably supervise the firm's LREA-related activities and detect red flags. Moreover, there were no supervisory controls prohibiting WHM customers generated from the LREA radio shows and workshops from purchasing the Affiliated Private Offerings before the customer established a substantive relationship.

The NAC imposed sanctions that appropriately remediate WHM's and Murphy's serious misconduct, while reducing the likelihood of future reoccurrence. The Commission should affirm the NAC's decision in all respects.[23]

A. WHM Sold Unregistered Securities that Were Not Exempt from Registration, in Violation of FINRA's Rule

The NAC correctly found that WHM violated FINRA Rule 2010 by selling unregistered, non-exempt securities, in contravention of Section 5 of the Securities Act. RP 14833. The Commission should affirm these findings.

Section 5(a) and (c) of the Securities Act prohibit any person from offering or selling securities without a registration statement filed or in effect or an available exemption from registration. *See* 15 U.S.C. § 77e(a) and (c). The Securities Act imposes strict liability on offerors and sellers of unregistered securities and Section 5 liability attaches to any person who

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[23] The Applicants request oral argument in connection with their application for review. Br. ii. FINRA opposes this request because the issues raised in this application can be determined sufficiently on the basis of the record and the briefs filed by the parties. *See* Rule 451(a) of the Commission's Rules of Practice.

has engaged in any steps necessary to distribute unregistered securities. *Swenson v. Engelstad*, 626 F.2d 421, 424 (5th Cir. 1980); *SEC v. Tecumseh Holdings Corp.*, 2009 U.S. Dist. LEXIS 119869, at *8 (S.D.N.Y. Dec. 22, 2009). A prima facie case for a Section 5 violation must establish that "(1) no registration statement was in effect as to the securities, (2) the [respondent] sold or offered to sell these securities, and (3) interstate transportation or communication and the mails were used in connection with the sale or offer of sale." *SEC v. Cont'l Tobacco Co.*, 463 F.2d 137, 155 (5th Cir. 1972).

Upon establishing a prima facie case, the burden then shifts to the respondent to demonstrate that "it was entitled to a claimed exemption, i.e., that there was no public offering of the securities and that registration was not otherwise required." *Id.* at 156. Proof of a registration exemption must be "explicit, exact, and not built on conclusory statements." *Lively v. Hirschfeld*, 440 F.2d 631, 633 (10th Cir. 1971). A Section 5 violation is also a violation of FINRA Rule 2010. *KCD Fin. Inc.*, Exchange Act Release No. 80340, 2017 SEC LEXIS 986, at *13 (Mar. 29, 2017).

Enforcement established a prima facie case that WHM sold securities,[24] using the mail and instrumentalities of interstate commerce, while there was no registration statement filed or in effect. RP 14828. WHM, however, failed to prove that a valid exemption applied.

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[24] On appeal before the NAC, WHM claimed that it was only a referring or "introducing broker" and not the "seller" of the Affiliated Private Offerings. RP 14829. Now WHM appears to agree that it was a necessary participant "in the chain of sale" of unregistered securities and thus is subject to Section 5 liability. Br. 10 n.45; *see also SEC v. Murphy*, 626 F.2d 633, 651 (9th Cir. 1980) (defining a "necessary participant" for Section 5 liability as one who, "but for [their] participation," the securities transaction would not have taken place).

1. WHM Failed to Prove It Relied on the Rule 506 Exemption

Throughout these proceedings, WHM has claimed that it offered and sold interests in the affiliated offerings pursuant to Regulation D, Rule 506.[25] RP13631-32. SEC Rule 506 permits sales of unregistered securities, so long as the offers and sales adhere to, among other things, the conditions provided under Regulation D, Rule 502(c). *See* 17 C.F.R. § 230.506(b). Rule 502(c) requires that "neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising." 17 C.F.R. § 230.502(c). A violation of the general solicitation prohibition under Rule 502(c) occurs when communications

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[25] The Applicants assert that the NAC arbitrarily rejected the firm's reliance on other statutory exemption provisions, including SEC Rule 508, Section 4(a)(2), and SEC Rule 506(c). Br. 29-31. Their claim, however, lacks merit. As a preliminary matter, the parties to this proceeding jointly stipulated on December 15, 2015, that the *only* relevant federal exemption WHM claimed was Regulation D, Rule 506. *See* RP 13631-32; *see also Joseph Abbondante*, 58 S.E.C. 1082, 1088 n.12 (2006) ("Stipulated facts serve important policy interests in the adjudicatory process . . . we will honor stipulations in the absence of compelling circumstances."), *aff'd* 209 F. App'x 6 (2d Cir. 2006).

In any event, as the NAC ruled, the other statutory exemptions do not apply here. RP 14836-37. Pursuant to Rule 508, a failure to comply with certain terms or requirements of Regulation D will not result in the loss of a Section 5 exemption if the failure "was insignificant with respect to the offering as a whole." 17 C.F.R. § 230.508. But, as the rule states, Rule 502(c) violations *are significant* to the entire offering. 17 C.F.R. § 230.508(a)(2). Moreover, WHM's sales to 23 investors by general solicitation was not an "inadvertent mistake affecting [only] one prospective investor." RP 14836-37.

WHM also could not rely Section 4(a)(2). RP 14837. Not only did the parties stipulate that Regulation D, Rule 506 was the only claimed exemption that WHM relied upon in this case, even if WHM had relied on Section 4(a)(2), the statutory provision also prohibits general solicitation, which WHM impermissibly violated. *See Non-Public Offering Exemption*, Securities Exchange Act Release No. 4552, 1962 SEC LEXIS 166, at *3 (Nov. 6, 1962).

The Rule 506(c) exemption is also invalid because it only permits offerings to "not [be] subject to limitation on manner of offering," if all purchasers are accredited investors. 17 C.F.R. § 230.506(c); RP 14837. But WHM's unregistered sales were made to both accredited and non-accredited investors. RP 11055. Thus, Rule 506(c) does not apply. Lastly, the safe harbor protections under SEC Rule 502(c) that WHM has cited to apply only to issuer Form D filing obligations, which is not the case here.

to the public (1) are made by an issuer or a person acting on its behalf; (2) are "offers" or "sales" of securities; and (3) are a general solicitation. *Brian Prendergast*, 55. S.E.C. 289, 307 (2001).

Unquestionably, WHM acted on behalf of GEF, MFREF2 and MFREF3 as a compensated selling agent and thus the first element is met. RP 7164. WHM's unregistered sales, however, did not qualify for the Rule 506 exemption because it *offered* and sold over $1 million worth of securities to 23 investors via a general solicitation.

2. The LREA Radio Shows and Workshops Were Offers of Securities

The NAC correctly determined that the LREA radio shows and workshops were offers of securities. RP 14830-32. Securities Act Section 2(3) defines "offer to sell," "offer for sale" or "offer" to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." 15 U.S.C. § 77b(a)(3). These statutory terms "which Congress expressly intended to define broadly . . . are expansive enough to encompass the entire selling process, including the seller/agent transaction." *United States v. Naftalin*, 441 U.S. 768, 773 (1979). The Commission has also long interpreted "offer to sell" to include "publicity efforts that may not be phrased expressly in terms of an offer but [that] . . . stimulate interest in a securities offering." *KCD*, 2017 SEC LEXIS 986, at *20 (internal quotation marks omitted). As the NAC found, during the active sale of each Affiliated Private Offering, WHM representatives hosted radio shows and conducted workshops not just for educational purposes, but to "awaken an interest in real estate investment opportunities" and attract potential investors to purchase securities in the Affiliated Private Offerings. RP 14831; *see KCD*, 2017 SEC LEXIS 986, at *20.

The LREA radio shows and workshops were intended to, and did, arouse public interest in real estate investment opportunities. As Hutton admitted, the LREA radio shows and

commercials were the pipeline towards coaxing listeners to attend a LREA workshop. RP 6778-79. WHM's chain of solicitation began with the radio shows where Price discussed real estate investment opportunities, by focusing on multi-family apartment housing as a passive investment—which was the same approach that GEF, MFREF2, and MFREF3 were using. RP 9253-9412. On the radio, Price touted the financial benefits of investing in private placements—a securities investment—while comparing it to traditional investing like the stock market. RP 9254-81, 13521. She discussed private placements in detail, including what a private placement was, what the term "accredited investor" means, and how a private placement is an investment that "now everybody can actually get involved with." RP 9282-84. Price also remarked favorably about her own investment in the GEF offering, and the radio advertised that securities were being sold though WHM. RP 6459-60; *see also Thoroughbred Racing Stable*, 1976 SEC No-Act. LEXIS 5, at *2 (Jan. 5, 1976) (finding an "offer" when, although not couched as an express offer, the advertisement contributes to arousing public interest and conditioning the public mind).

WHM's solicitation chain then continued at the LREA workshops when WHM representatives and other invited hosts discussed more specifically investing in private placements. For example, referencing the workshop as a "sales pitch," the Introductory Workshop dedicated an entire segment to what private placements were, who could invest, and why a private placement might be beneficial to an investor's portfolio. RP 13558-60. At the end of the Introductory Workshop, attendees received invitations to meet with a broker-dealer representative (i.e., Price or Hutton) to learn about real estate investment opportunities:

> "If you still want to proceed, we will move into the application process with the broker dealer[,] review your application and potentially introduce you to a private placement issuer."

RP 13577. Indeed, a LREA executive outright told attendees, "There is an affiliate company that offers multi-family opportunities for those who are deemed suitable by our 3rd party broker-dealer, William H. Murphy." RP 13588. The LREA radio shows and workshops easily qualify as offers to sell securities. For their selling efforts, WHM, Price and Hutton received commissions on each sale. RP 6710, 6735, 7164, 7438-39, 12056, 10303. *See Carl M. Loeb*, 38 S.E.C. 843, 850 (1959) (finding distribution participants that collaborate on publicity efforts are "participating directly or indirectly in an offer to sell" or a solicitation of an offer to buy securities, in violation of Section 5(c)).

WHM makes unsound arguments against the NAC's finding that the LREA radio shows and workshops constituted offers. First, WHM argues that, because the LREA communications were "generic" and referenced no security, they therefore were not "offers" that violated Rule 502(c). Br. 22. Since 1964, however, the SEC has held that the term "offer" broadly includes any communication intended to procure orders for a security, even if the communication on its face does not mention a particular offering but awakens an interest in the security. *See KCD*, 2017 SEC LEXIS 986, at *20 (finding a generic article published on an unrestricted website an "offer" of securities); *Prendergast*, 55 S.E.C. at 307-08 (finding generic advertisements were general solicitations used to offer and sell specific securities); *Gearhart & Otis, Inc.*, 42 S.E.C. 1, 26 (1964) (same); *Gerald F. Gerstenfeld*, 1985 SEC No-Act. LEXIS 2790 (Dec. 3, 1985) (finding a generic advertisement inviting the public to call or write for additional information through its syndicator to be an "offer" of securities in violation of Rule 502(c)). Not mentioning

each Affiliated Private Offering by their names did not negate that WHM's solicitations at the LREA radio shows and workshops constituted offers.[26]

Second, WHM erroneously asserts that, consistent with SEC guidance, the content of the LREA radio shows and workshops was merely factual business information that did not violate Rule 502(c). Br. 28. WHM, however, conveniently ignores relevant portions of that guidance that undermines its argument. Question 256.24 of *SEC Compliance and Disclosure Interpretations: Securities Act Rules*, states that certain publicly disseminated information, such as factual business information "that does not condition the public mind or arouse public interest in a securities offering," is not an offer. If, however, the information does involve an offer of securities, than this is general solicitation that violates Rule 502(c). https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm (last visited Feb. 15, 2019). Question 256.25 clarifies that factual business information is generally limited to

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[26] WHM unsuccessfully attempts to distinguish SEC precedent in *Gearhart*, *Prendergast*, *KCD*, and *Gerstenfeld* based on factual differences—all to no avail. Br. 25-28. In fact, the legal propositions in these cases *supported* the NAC's findings. For example, the Section 5 finding in *Gearhart* did not rely on evidence of fraud in the offering materials, material misrepresentations, or investor loss, contrary to WHM's representations. Br. 25. And while the literature in *Gearhart* was sent to 3,000 securities dealers before the registration statement was filed, WHM conceivably casted an even wider net through the LREA radio broadcasts, which aired on stations throughout the Houston, Texas and Sacramento Valley, California areas. The SEC in *Prendergast* found that the hedge fund seminar was intended to offer and sell Prism units; but the SEC never stated that a general advertisement must serve the *single* purpose of attracting investors in order to constitute a general solicitation. Br. 26, 29. That prospective investors had restricted access to issuer information, a cooling off period was implemented, or the fund's specific name went unmentioned, are unimportant details that are not required elements for the SEC's findings in *KCD*. Br. 28. Lastly, WHM contends that, unlike the seller in *Gerstenfeld*, it is not the actual seller or issuer, but merely a participant in the chain of distribution. Br. 27. WHM raises a similar argument later in its brief that it was not a seller but a participant in the sale of securities. Br. 33. These role distinctions are immaterial when determining who is an offeror of securities for purposes of Section 5 liability. Indeed, the Rule 506 exemption applies to both issuers and participants acting on their behalf. WHM was a selling participant in unregistered offerings, acting on behalf of the limited liability companies, and thus liable under Rule 502(c).

information about the issuer, its business, financial condition, products, or services. *See id.* Importantly, Question 256.25 emphasizes that even factual business information may be general advertising if it is presented in a manner that constitutes an offer of securities. *See id.*

The record is clear that the LREA public communications included much more than "factual business information." At the radio shows and workshops, Price urged the public to consider investing in private placement securities in lieu of the traditional stock market. RP 9282-84. Price encouraged listeners and attendees to add multi-family real estate to their portfolios, which were the targeted properties the LREA affiliated funds sought to acquire. RP 9264. Referring to one workshop as a "sales pitch," Price advised attendees that she had an "investment vehicle" that would allow "investors" to "achieve returns that can exceed more traditional forms of investing." RP 13549. These promotional statements conditioned the public mind to invest in the Affiliated Private Offerings, and thus were offers of securities.

Third, WHM downplays its role as selling participant by contending that the LREA advertisements were for networking and educational purposes. Br. 27, 32. Although one of LREA's stated purposes was to educate the public about real estate, any educational component of the LREA business coexisted with a chain of solicitation intended to procure investors for the Affiliated Private Offerings.

3. WHM Engaged in a General Solicitation

The NAC correctly found that the LREA communications met the definition of a general solicitation. RP 14832-33. Securities Act Rule 502(c) defines a "general solicitation or general advertising" to include "[a]ny 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." 17 C.F.R. § 230.502(c). The LREA radio slows and workshops were, by definition, general solicitations.[27]

To avoid a general solicitation, a substantive relationship must exist between the issuer or its agents and the offerees *before* the solicitation of such offerees. *H.B. Shaine & Co.*, 1987 SEC No-Act. LEXIS 2004, at *1 (May 1, 1987).[28] The Applicants failed to meet this exception. The NAC considered the nature of the relationships between WHM, the issuers, and the offerees, and found that no substantive relationship existed before WHM solicited the prospective investors at the LREA radio shows and workshops. RP 14832. The LREA communications were geared towards to the general public with the end goal of procuring investors to purchase the Affiliated Private Offerings. RP 6789-90. None of the LREA radio listeners or workshop attendees had a pre-existing relationship with the affiliated issuers or WHM. RP 14, 721, 13983, 13998. Therefore, the NAC correctly found that WHM breached the general solicitation prohibition under Rule 502(c) and sold unregistered securities without an available exemption, in violation of Securities Act Section 5.

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[27] LREA's posting of the radio shows as podcasts on its unrestricted website also constituted a general solicitation. *See* RP 14833 n. 17; *see also In the Matter of Eureeca Capital SPC*, Exchange Act Release No. 73569, 2014 SEC LEXIS 4278, at *4 (Nov. 10, 2014).

[28] WHM asserts that the NAC failed to recognize that it established a substantive relationship "before WHM introduced the referred clients to Issuers." Br. 23. But WHM misses the critical point that an established substantive relationship depends on the special knowledge of, or close relationship the *offeree* had with, the issuer or its agent *at the time of an offer. Mark v. FSC Sec. Corp.*, 870 F.2d 331, 334 (6th Cir. 1989) ("Once such a wide-ranging distribution scheme is undertaken, evidence that each and every offeree had access to enough relevant information so as to make registration unnecessary is required to rebut the public offering inference."); *see also Murphy*, 626 F.2d at 647 (finding that a nonpublic offering is not in need of Section 5 protection where the "offerees" have relationships with the issuer affording them access to extensive information that a registration would reveal); *NASD Notice to Members 05-18*, 2005 NASD LEXIS 25, at *18 (Mar. 2005) (explaining the existence of an adequate pre-existing relationship between a member and the offeree is "[a] critical factor in determining whether a communication is appropriately limited, and thus not a 'general solicitation'").

WHM asserts that public communications involving broker-dealer networking or referral arrangements are acceptable so long as broker-dealers supervise the activities of the non-registered entity. Br. 14. But WHM misses the point. Whether broker-dealer networking or referral arrangements are acceptable forms of doing business is not an issue presented in this case. WHM cites to numerous SEC no-action letters to support its argument, including *Welton St. Invs., LLC*, *The Somerset Grp.*, *Mid-Hudson Sav. Bank FSB*, *Am. Council of Life Insurers*, and *Chubb Sec. Corp.* Br. 14 n.68. Those letters, however, considered whether an entity had to register as a broker-dealer under *Section 15(a)* of the Securities Exchange Act of 1934 ("Exchange Act"), not whether a broker-dealer selling participant, like WHM, could offer and sell unregistered securities by general solicitation. Moreover, the SEC no-action letters never stated that networking or referral arrangements involving "general solicitations did not violate §5," as WHM mistakenly claims. *See* Br. 14 n.68, 20. In fact, the SEC does not mention Section 5 at all. Likewise, the *Bateman Eichler*, *H.B. Shaine*, *IPONET*, and *E.F. Hutton* no-action letters considered the narrow question of whether the activity proposed would, if implemented, constitute a general solicitation. The no-action letters never opined on whether a broker-dealer networking or referral arrangement would protect a selling agent, like WHM, from breaching the ban on general solicitation. WHM's argument thus fails.

WHM next argues that it had protective measures, such as a "cooling off period" and limited access to the offering documents, to ensure that sales were made to qualified investors. Br. 28. The argument, however, is consistent with neither the law nor the facts. The cooling off period was an undocumented period of time (i.e., 30 days) that LREA workshop attendees had to wait after meeting with WHM representatives before receiving issuer offering documents and completing their sale transactions. The evidence demonstrated that some of the 23 investors did

not even wait the 30 day period before their securities purchases. RP 10305. In any event, WHM's purported cooling off period is irrelevant to determining whether the radio shows and workshops conflicted with Rule 502(c). WHM cites no legal authority for the proposition that a general solicitation can be cured through WHM's cooling off period.[29] Rather, SEC staff has emphasized that the relevant inquiry is whether the substantive relationship with offerees is "pre-existing," meaning before the securities offering commences or before broker-dealer participation in the offering. *Cf. SEC Compliance and Disclosure Interpretations: Securities Act Rules*, Question 256.30 (explaining there is no minimum waiting period so long as the broker-dealer establishes the relationship before participation in the offering).

Similarly, the fact that WHM withheld providing offering documents to customers for some period of time post its offers does not reverse WHM's 502(c) violation. Br. 24, 32-33.

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[29] WHM misconstrues the no-action letters in *Bateman Eichler*, *E.F. Hutton*, *H.B. Shaine*, and *Lamp Technologies*, to claim, mistakenly, that a cooling off period followed by an after-the-fact substantive relationship being formed with investors protected or cured its general solicitation. Br. 23. But these letters stand for no such proposition. The interval referenced in those letters established which private placements a broker-dealer could offer to a prospective customer once a substantive relationship with the customer was formed. For example, in *E.F. Hutton*, the no-action letter stated that a violation of Rule 502(c) would not occur "if the relationship was established prior to the time Hutton began participating in the Regulation D offering." This is certainly not what occurred in this case. 1985 SEC No-Act. LEXIS 2917, at *2 (Dec. 3, 1985).

Similarly, in *Lamp Technologies* and *IPONET* the interval applied before any private offers were extended to subscribers through a password-protected website, and only after it was established from a generic questionnaire that the subscriber was an accredited or sophisticated investor. In *Bateman Eichler*, select prospective offerees who completed a generic questionnaire were unable to purchase securities currently offered or contemplated for offering and the 45-day period was applied before their purchases of later offerings. Likewise, the no-action letter in *H.B. Shaine* required that sufficient time elapsed between the completion of a questionnaire and the contemplation or inception of any particular offering. Reliance on the Rule 506 exemption strictly required WHM to establish a substantive relationship with the investors *before* it offered securities in the Affiliated Private Offerings. *Bateman Eichler*, 1985 SEC No-Act. LEXIS 2918, at *1 (Dec. 3, 1985).

Successful reliance on a federal registration exemption necessitated "explicit, exact" proof, *Lively*, 440 F.2d at 633, that—at the time of WHM's *offer*—the solicited investors did not need the protections of the registration requirements because their relationship with the issuer afforded them "access to or disclosure of the sort of information about the issuer" that registration would cover. *Murphy*, 626 F.2d at 647. WHM did not have a pre-existing substantive relationship before it solicited investors publicly on the radio and at the LREA workshops, irrespective of when offering documents were provided to investors. The LREA radio shows and workshops were general solicitations of an offer to buy securities, made when WHM had no pre-existing substantive relationships with the 23 investors who purchased over $1 million worth of securities in the Affiliated Private Offerings. RP 14832-83. Because WHM engaged in a general solicitation, the Rule 506 exemption was not available.

The NAC correctly found that WHM engaged in unregistered sales of securities in contravention of Section 5 of the Securities Act, which violated FINRA Rule 2010. The Commission should sustain the NAC's findings.

B. WHM's and Murphy's Unreasonable Supervision of the LREA OSJ Violated NASD Rule 3010 and FINRA Rule 2010

The record amply supports the NAC's findings that WHM and Murphy failed to establish or maintain a supervisory system, including WSPs, reasonably designed to ensure compliance with the Securities Act registration requirements. RP 14837-39. Murphy was ultimately responsible for supervising the LREA OSJ and failed in his supervision duties at every turn.

NASD Rule 3010(a) requires FINRA members to establish and maintain a system to effectively supervise the activities of associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. A firm's supervisory system must include written procedures that establish, maintain, and

enforce supervision over the types of business the firm engages in and the activities of its registered and associated persons. NASD Rule 3010(b). Written procedures must also set forth mechanisms to ensure compliance, detect violations, and address any red flags. *See Rita H. Malm*, 52 S.E.C. 64, 69 n.17 (1994) ("The presence of procedures alone is not enough. Without sufficient implementation, guidelines and strictures do not ensure compliance."). Final responsibility for proper supervision rests with the member.

Murphy, under the firm's procedures, was responsible for supervising all private placement activities, including any communications with the public and thus was accountable for the firm's compliance. RP 7222-23, 7225, 11705, 11761. While Hutton was the designated registered principal at the LREA OSJ, Murphy was ultimately responsible for its supervision. RP 6912, 7296, 11705. No WHM new account form was accepted, or securities transaction completed, without Murphy's approval. RP 6196, 6913-14, 6917, 14382. Without question, Murphy was keenly aware of the sales of the Affiliated Private Offerings. He nonetheless made no reasonable attempts to avoid the violative unregistered sales.

WHM's WSPs were deficient in light of the firm's LREA-related sales activities. They contained no procedures for, or specific references to, its LREA OSJ. Nor did it describe they compliance services WHM provided to LREA. And the firm's supervisory control procedures failed to recognize LREA as a firm OSJ branch. RP 11693-962, 13988.

WHM's WSPs failed to address LREA's public advertising to ensure compliance with the Rule 506 exemption, and particularly, Rule 502(c)'s general solicitation prohibition. For example, there were no mechanisms employed to prohibit new customers generated from LREA radio shows and workshops from purchasing the "live" unregistered offerings before the customer established a substantive relationship with WHM or the issuer. WHM and Murphy,

attempted to use a cooling off period of 30 days, but it was not documented in the WSPs, and was not followed for each unregistered sale. RP 6754. Even Murphy could not explain when the cooling off period began and ended, calling it "a moving target." RP 7265-70, 7284. Indeed, four investors purchased the Affiliated Private Offerings before the cooling off period expired.[30] RP 7818.

Murphy also failed to supervise the LREA OSJ and its registered personnel. Murphy knew of Hutton's limited private placement supervisory experience, but never conducted a formal branch review or provided Hutton with formal supervisory training. RP 7287. Murphy only provided oral instructions to Hutton regarding his principal duties and instructed Hutton and Price not to mention the Affiliated Private Offerings or "securities" directly. RP 7237-38. He provided no formal guidance, however, on what types of LREA communications constituted a general solicitation in contravention of Section 5, and was unconcerned about the nature of Price's selling efforts at the one-on-one meetings. RP 7238, 7252, 7273. Given Hutton's limited experience in supervising private placements and Price's lack of previous securities experience, Murphy's supervision efforts were unreasonable.

WHM also had no supervisory procedures for detecting red flags when Hutton monitored the radio shows, workshops, or private placement sales. RP 6752-53, 7236-37. For example, Hutton could not point to any directives on how to determine whether a communication is a

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[30] The Applicants argue that "the cooling off period supervision requirements and details were included in LREA's WSPs." Br. 35. But Hutton, LREA's compliance officer, admitted that he never even read the LREA procedures. RP 6770. Nonetheless, the minimal references to a cooling off period found in LREA's—and not WHM's—procedures do not hardly qualify as a firm supervisory procedure reasonably designed to achieve compliance with applicable securities laws. *Cf. Gary E. Bryant*, 51 S.E.C. 463, 471 (1993) (finding a supervision violation when firm procedures only stated the prohibited activities but established no mechanism to achieve compliance).

general solicitation, or how to investigate red flags when supervising the LREA radio shows and workshops to prevent a general solicitation. RP 6752-53, 7236-37. Despite Murphy's admitted concern about WHM representatives conditioning the market through the LREA radio shows and workshops and thereby violating the federal securities laws, he implemented no procedures or effective supervisory controls to avoid a Section 5 violation. RP 7173. *Wedbush Sec. Inc.*, Exchange Act Release No. 78568, 2016 SEC LEXIS 2794, at *26-27 (Aug. 12, 2016) ("Supervisors must respond with the utmost vigilance when there is any indication of irregularity, and take decisive action"), *aff'd* 719 F. App'x 724 (9th Cir. 2018). WHM's unrestricted public solicitations led 23 investors to buy securities without Securities Act registration protection—an obvious red flag that Murphy ignored.

The Applicants quibble that the NAC did not recognize myriad supervisory activities that WHM implemented. Br. 33-34. For example, they claim—without support—that they provided "hands on training" and "extensive monitoring," Br. at 34. But the record demonstrated that the reviews Murphy performed at the LREA OSJ were cursory and undocumented. For example, while the Applicants cite to the "CRM system to monitor client relationships" as a supervisory protective measure, Br. 34, Murphy denied that he used "the CRM database at all to monitor and supervise the activity at the LREA branch," stating, "I didn't use that as my primary supervisory."[31] RP 7324.

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[31] While the Applicants claim that disclaimers contained in the LREA communications stating that WHM conducted securities transactions were a protective measure to ensure compliance with SEC and FINRA rules, the record reflects otherwise. Br. 11-12. The disclaimers, which were widely disseminated, served as a billboard to the public that WHM was an active sales participant in a LREA-related offering. *Accord Thoroughbred*, 1976 SEC No-Act. LEXIS 5, at *3 (finding disclaimers stating that an advertisement is not a solicitation to buy or sell securities does not preclude the communication from being viewed as an offer).

Each of these examples support that the NAC correctly found that WHM and Murphy violated NASD Rule 3010 and FINRA Rule 2010. The Commission should sustain the NAC's findings.

C. FINRA Properly Exercised Its Jurisdiction Over WHM and Murphy

The Applicants erroneously argue that the Exchange Act does not provide FINRA with the authority to discipline members for violating the Securities Act and that FINRA should have brought an enforcement action in federal court. Br. 48-50. FINRA exercises disciplinary authority over its members and is mandated to enforce compliance with securities laws and FINRA rules, which is what FINRA did here. *See* 15 U.S.C. § 78o-3(b) and (h); *see also D.L. Cromwell Inv., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 157 (2d Cir. 2002) (stating FINRA is charged with "conducting investigations and commencing disciplinary proceedings against [FINRA] member firms and their associated member representatives relating to compliance with the federal securities laws and regulations"). Indeed, FINRA has statutory authority to discipline WHM for its Section 5 violation or any other violation of the federal securities laws. *Birkelbach v. SEC*, 751 F.3d 472, 475 (7th Cir. 2014) ("FINRA is empowered to bring disciplinary actions and impose sanctions to enforce its members' compliance with federal securities laws, SEC regulations, and FINRA's own rules and regulations.").

FINRA unquestionably has personal jurisdiction to sanction WHM's violation of FINRA Rule 2010. *KCD*, 2017 SEC LEXIS 986, at *13. "A violation of Rule 2010 may be based on any conduct, not simply conduct that violates the Exchange Act." *Id.* Moreover, FINRA, and not the federal courts, is the appropriate tribunal for its enforcement proceedings. *See* 15 U.S.C. § 78o-3(b)(2) and (h) (empowering FINRA to enforce compliance of its rules through its own adjudicatory process). WHM participated in over $1 million worth of sales of unregistered

securities in contravention of Securities Act Section 5, which is business conduct inconsistent just and equitable principles of trade. *Midas Sec. LLC*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *46 n.63 (Jan. 20, 2012) ("A violation of Securities Act Section 5 also violates [FINRA] Rule 2[0]10."). FINRA's authority to discipline WHM's and Murphy's misconduct is well established.

D. The Procedural Arguments Lack Merit

The Applicants a long list of procedural arguments, most without supporting legal authority, including that (1) the Hearing Panel lacked expertise and training; (2) expert testimony the Applicants sought to provide at the hearing was relevant; (3) the Hearing Officer abused her discretion; (4) the Applicants' due process rights were violated and the proceeding was biased; (5) the Hearing Panel erred in denying the Applicants' reliance on counsel's advice claim; (6) the Hearing Officer was not appointed by the President, a court of law, or department head in violation of the Appointments Clause; (7) FINRA provided no fair notice of the proceeding; and (8) FINRA proceedings are not neutral. Br. 37-48, 50. For the reasons discussed below, the Commission should find that these procedural arguments lack merit.

First, the Applicants presume that the Hearing Panel lacked "expert knowledge" on private placement exemptions because the Hearing Officer determined that WHM's cooling off period was irrelevant. Br. at 37. But WHM's cooling off period *was* irrelevant to the question of whether a general solicitation violation had occurred on the radio and at the LREA workshops. As explained above, a substantive relationship between the firm and customer must be established *before* the offer of securities is made. In any event, not only can respondents not dictate the qualification of panel members, *see Dep't of Enforcement v. Sathianathan*, Complaint No. C9B030076, 2006 NASD Discip. LEXIS 3, at *53 (NASD NAC Feb. 21, 2006), *aff'd*,

Exchange Act Release No. 54722, 2006 SEC LEXIS 2572 (Nov. 8, 2006), the Hearing Officer's exclusion of irrelevant evidence had no bearing on whether the hearing panelists possessed the expertise to evaluate applicable federal securities laws and FINRA rules to render a fair decision. Indeed, neither WHM nor Murphy sought to disqualify any panel member's participation in this proceeding under FINRA Rule 9234. The Hearing Panel was properly constituted in this case.

Second, the Applicants contend that they were not permitted to present expert testimony. Br. 39. FINRA Rule 9263, however, gives Hearing Officers broad discretion to accept or reject expert testimony based on the complexities of the issues presented in the case. Contrary to the Applicants' view, this is *not* a case of first impression. Br. 1. The securities laws on broker-dealer obligations when selling unregistered securities are not novel, obscure, or overly complex to necessitate expert testimony. The NAC properly found no abuse of discretion, because expert testimony was not needed. RP 14840-41.

Third, the NAC likewise found no abuse of the Hearing Officer's discretion prohibiting WHM's overreaching cross examination of FINRA examiner, Eric Beck. RP 14841; Br. 39-42. Beck was not called to testify about his legal opinions or conclusions in this case. Instead, Beck testified to authenticate exhibits he collected during his examination, and a summary exhibit he prepared for the hearing. RP 7416-44. Furthermore, the NAC correctly concluded there was no abuse of discretion when the Hearing Officer curtailed questioning on the scope of Beck's investigation of the case. *Cf. Dep't of Enforcement v. Epstein*, Complaint No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *90 (FINRA NAC Dec. 20, 2007) (finding no error in the Hearing

Officer's decision to limit questions concerning the scope and adequacy of the FINRA staff's investigation), *aff'd*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217 (Jan. 30, 2009).[32]

Fourth, providing no evidentiary support, the Applicants assert that their due process rights were violated because "fact, legal, and regulatory interpretations were found against WHM." Br. 44. But, as the NAC rightly found, while FINRA is required to provide a fair procedure in disciplinary proceedings, "due process arguments fail, in their entirety, because FINRA is not subject to constitutional and common law due process requirements." *Dep't of Enforcement v. Sears*, Complaint No. C07050042, 2007 FINRA Discip. LEXIS 1, at *11 (FINRA NAC Sept. 24, 2007), *remanded on other grounds*, Exchange Act Release No. 58075, 2008 SEC LEXIS 1521 (July 1, 2008); *see also Benjamin Werner*, 44 S.E.C. 622, 625 (1971) ("[T]he Fourteenth Amendment imposes certain restraints on state action and is not applicable to [FINRA] proceedings."). Thus, Applicants' due process argument fails.

Moreover, any prejudice or bias claim that the Applicants raise, Br. 43, 45, requires demonstration that the proceeding was motivated by a discriminatory purpose, such as race, religion, or the "desire to prevent the exercise of a constitutionally protected right." *David Kristian Evansen*, Exchange Act Release No. 75531, 2015 SEC LEXIS 3080, at *44 (July 27, 2015). There is no such evidence of bias in this case. Providing statistics on the number of disciplinary proceedings or Hearing Officer rulings that were resolved in favor of a respondent

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[32] The NAC also rejected the argument that the Hearing Officer's rulings against cross examination also violated the Sixth Amendment confrontation clause. RP 14841 n.23; Br. 45. It is widely held the Sixth Amendment of the U.S. Constitution applies to *criminal* proceedings and not FINRA adjudications. *See, e.g.*, *SEC v. Jerry T. O'Brien, Inc.*, 467 U.S. 735, 742 (1984). Moreover, because FINRA is not a state actor, it is not subject to constitutional requirements. *Michael Earl McCune*, Exchange Act Release No. 77375, 2016 SEC LEXIS 1026, at *37 n.52 (Mar. 15, 2016), *aff'd*, 672 F. App'x 865 (10th Cir. 2016). Nonetheless, the record fully establishes that the Applicants had ample opportunity to cross examine any witness on the relevant issues.

does not prove that in *this* proceeding, the Hearing Officer or the Hearing Panel was biased against WHM and Murphy. *See, e.g.*, *Steven Robert Tomlinson*, Exchange Act Release No. 73825, 2014 SEC LEXIS 4982, at *27-28 (Dec. 11, 2014) (explaining that because respondent did not obtain the result he wanted or expected in the case did not in itself support a bias claim), *aff'd*, 637 F. App'x 49 (2d Cir. 2016).

Fifth, the NAC appropriately rejected the Applicants' reliance on advice of counsel claim. RP 14841; Br. 37. The claim is no defense to WHM's liability because scienter is not an element of a Section 5 violation. *See Rodney R. Schoemann*, Securities Act Release No. 9076, 2009 SEC LEXIS 3939, at *45 (Oct. 23, 2009) (finding advice of counsel as a liability defense only goes to the question of scienter and thus not applicable under Section 5's strict liability provisions).

Sixth, the NAC properly rejected the argument that the disciplinary proceeding violated the Appointments Clause because the Hearing Officer was not appointed by the President, a court of law, or department head. Br. 50-51. It is well-settled that "self-regulatory organizations, such as FINRA, are not 'Government-created, Government-appointed entit[ies],' and therefore do not 'unlawfully usurp power reserved to the executive branch.'" *Manuel P. Asensio*, Exchange Act Release No. 62645, 2010 SEC LEXIS 2521, at *6-7 (Aug. 4, 2010), *aff'd*, 447 F. App'x 984 (11th Cir. 2011).

Seventh, the Applicants' claim that the Hearing Officer was not neutral, that only two Hearing Panel's rulings were found in favor of WHM, and that "almost no disciplinary proceedings filed with formal complaints resolved in favor of a respondent." Br. 43, 45. But "[a]dverse rulings, by themselves, generally do not establish improper bias" or unfairness. *Scott Epstein*, 2009 SEC LEXIS 217, at *62; *accord Liteky v. United States*, 510 U.S. 540, 555

(1994) (stating that "judicial rulings alone almost never constitute a valid basis for a bias or partiality motion"). The Applicants, however, provide no substantive evidence that the disciplinary proceeding at hand contravened FINRA's Code of Procedure. They also fail to state with particularity how the Hearing Officer or disciplinary proceeding was unfair. For example, the Applicants argue that Enforcement spent hours of testimony on the PPMs of the private funds, but during Applicants' cross-examination, the Hearing Officer "limited its questioning," Br. 43. They, however, provide no citation or specific reference to the record or state how the PPMs were misrepresented during the testimony. Nonetheless, the NAC's *de novo* review of the entire record would have cured any prejudice by the Hearing Officer if any had existed. *Accord Dep't of Enforcement v. Padilla*, Complaint No. 2006005786501, 2012 FINRA Discip. LEXIS 46, at *34 (FINRA NAC Aug. 1, 2012). The Commission should reject this baseless argument.

Lastly, the NAC properly concluded the Applicants had fair notice of the securities laws and regulations at issue and the disciplinary proceeding was fair. RP 14842; Br. 46. The allegations against the Applicant's were plainly articulated in the complaint. WHM and Murphy were represented by counsel at the hearing and allowed to present their defenses before the Hearing Panel. After an eight-day evidentiary hearing, the Hearing Panel issued a well-explained and fully supported decision. FINRA did not disregard the *Bateman Eichler*, *IPONET*, *Lamp Technologies*, *and E.F. Hutton* SEC no-action letters. Those letters neither negated nor mitigated WHM's liability.

Lastly, the NAC's independent review of the entire record found no deviation from any procedural safeguards in this case. RP 14842; Br. 47-48. As FINRA members, the Applicants agreed to comply with FINRA's rules, including its code of procedure governing disciplinary proceedings. *See* FINRA Rule 0140(a). FINRA's Code of Procedure, which the Commission

has approved, is designed to eliminate perceived conflicts of interest. *See, e.g.*, FINRA Rule 9144 (providing the separation of functions in FINRA disciplinary proceedings). WHM and Murphy were afforded the opportunity to fully litigate and defend themselves in accordance with FINRA's Code of Procedure and the Exchange Act.[33]

For all of these reasons, the Commission should affirm the NAC's rulings on Applicants' procedural arguments and sustain the NAC's findings of violation.

E. FINRA's Sanctions Remedy the Unlawful Sales of Unregistered Securities and Supervisory Failures

The NAC fined WHM $50,000 and ordered it to disgorge $23,230.05, plus prejudgment interest, for selling unregistered, non-exempt securities. RP 14850. For their failure to supervise, the NAC separately fined WHM and Murphy $50,000, jointly and severally, suspended Murphy in all capacities for six months, and ordered Murphy to requalify by examination in any capacity requiring qualification. RP 14850. The sanctions imposed by the NAC are appropriately remedial and fall within the recommended FINRA Sanction Guidelines ("Guidelines"). The Commission should affirm the NAC's sanctions in all respects.

1. The Sanctions Against WHM for Its Unregistered, Non-Exempt Sales of Securities Are Warranted

For sales of unregistered securities, the Guidelines recommended a fine between $2,500 and $73,000, a suspension in any and all member firm activities or functions for up to 30

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[33] The Applicants broadly assert that Hearing Officers have undeniable conflicts of interests, Br. 47, but provide no evidence of a conflict of interest during this proceeding, or in general. The record demonstrated instead that WHM and Murphy never moved to recuse or disqualify the Hearing Officer based on bias or a conflict of interest as FINRA's rules require. *See* FINRA Rule 9233(b).

business days or until procedural deficiencies are remedied, and where appropriate, disgorgement.[34]

The NAC found that only aggravating factors applied to WHM's misconduct. RP 14844-46. WHM sold over $1 million in unregistered, non-exempt securities to 23 investors, which is a significant amount.[35] RP 14844-45. WHM's misconduct was not incidental; it involved several sales transactions in three separate offerings, extending over a twenty-two month period.[36] RP 14845. WHM disregarded obvious red flags suggesting that the unregistered sales were made by general solicitation.[37] Murphy knew or should have known that having WHM representatives host radio shows and workshops to obtain potential investors in the affiliated offerings was risky. He testified that placing LREA workshop attendees as investors in live offerings "bothered" him. RP 7166. Yet, WHM, through Murphy, ignored these obvious red flags and failed to ensure that it did not sell unregistered securities in contravention of Section 5. Moreover, WHM financially gained from its unlawful sales;[38] and despite WHM's defined duties as a paid selling agent provided in LREA's business plan, the OSJ Agreement, the Joint Client Services Agreement, the selling agreements and other offering documents, WHM repeatedly refused to accept its

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34 *See FINRA Sanction Guidelines* 24 (2017), https://www.finra.org/sites/default/files/2017_Sanction_Guidelines.pdf [hereinafter *Guidelines*]. A copy of the relevant Guidelines are included as Attachment A.

35 *See id.* (Specific Consideration No. 3).

36 *Id.*

37 *See id.* (Specific Consideration No. 6).

38 *See id.* at 8 (Principal Considerations in Determining Sanctions, No. 16).

responsibility as an offering participant.[39] RP 14845. Lastly, WHM's blatant disregard of complying with the securities laws forbidding unregistered sales without a valid registration exemption was intentional or, at a minimum, reckless.[40] RP 14845. Given WHM's substantial level of unregistered sales and multiple aggravating factors, and consistent with the Guidelines, the NAC fined WHM $50,000, and reduced the disgorgement amount to $23,230.05, plus prejudgment interest, to remedy WHM's misconduct. RP 14847-48. The Commission should sustain these sanctions.

2. The Sanctions Against WHM and Murphy for Their Unreasonable Supervision Are Appropriate

The NAC found only aggravating factors surrounding WHM's and Murphy's supervisory violations, which were egregious. RP 14848-49. The Guidelines recommended imposing a fine between $5,000 and $73,000, and suspending the responsible individual in all supervisory capacities for up to 30 business days—or in egregious cases—imposing a longer suspension up to two years or a bar.[41] The Guidelines provided separate sanction guidelines for deficient

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[39] *See id.* at 7 (Principal Considerations in Determining Sanctions, No. 2). The NAC also acknowledged the Hearing Panel's observation that WHM created the Amended Joint Client Services Agreement to "improperly give the appearance that" LREA was not involved in the sales of its affiliated offerings. *See id.* at 7-8 (Principal Considerations in Determining Sanctions, Nos. 10, 12). WHM and Murphy claimed before the NAC that the Amended Joint Client Services Agreement was produced to FINRA staff "prior to the hearing" and created to correct inaccuracies in describing LREA's business. Their assertions, however, did not eliminate the Hearing Panel's stated concern of the nature and timing of its creation and its first submission as evidence post-filing of the complaint, and the NAC appropriately found no reason to overturn the Hearing Panel's findings. RP 14846, n.35. In revisiting this issue, the Applicants argue that "contracts should reflect the reality of the parties' agreement." Br. 37. In any event, amending substantial provisions of an agreement directly related to the Respondents' misconduct at issue during a FINRA investigation, and producing the amendment *after* the completed investigation and the filing of Enforcement's complaint, muddles the integrity of the evidence.

[40] *See id.* at 24 (Specific Consideration No. 1).

[41] *See id.*, at 105.

written supervisory procedures, to include a fine between $1,000 and $37,000 and, in egregious cases, suspending the responsible individual in any or all capacities for up to one year and suspending or limiting the firm's activities for up to 30 business days or until the procedures are amended to conform to the rule requirements.[42]

WHM, through Murphy, failed to investigate obvious red flags signaling a securities violation. In particular, Murphy was responsible for the onboarding and servicing of the LREA OSJ. RP 8251-66, 7225, 7269. He permitted Price and Hutton to conduct radio shows and workshops on behalf of LREA and WHM and approved the LREA scripts and advertising. RP 14848. Thus, Murphy knew, or should have known, that the LREA radio shows and workshops would generate unregistered, non-exempt sales to investors.

Murphy's periodic inspections and reviews of the LREA OSJ activities were largely undocumented and ineffectual. RP 14848. WHM and Murphy failed to detect that its registered representatives were extending unregistered offers and sales to the general public in contravention of the securities laws and applicable FINRA rules. RP 14848. Murphy knew that, before joining WHM, Price had no securities background and Hutton had less than one year of experience in supervising private placements. RP 14848. Yet, WHM and Murphy failed to provide Hutton with any formal supervisory training to ensure he carried out his supervisory responsibilities adequately, and Price and Hutton were only verbally instructed to never mention any specific securities while soliciting the public for potential investors in the Affiliated Private Offerings. RP 14848. WHM's WSPs were also deficient. Murphy was responsible for WHM's WSPs, yet he failed to include procedures to effectively supervise its LREA OSJ and related sales activities. RP 14849. The WSPs barely mentioned the LREA OSJ, much less addressed

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42 *Id.*

LREA's public advertising to ensure compliance with the general solicitation prohibition. RP 14849. WHM's lack of adequate procedures on soliciting sales of unregistered securities via public radio and open seminars led 23 new customers to invest over $1 million in the Affiliated Private Offerings in contravention of Securities Act Section 5.

Considering these substantial aggravating factors, while observing that WHM is a small-sized firm, the NAC fined WHM and Murphy $50,000, jointly and severally, suspended Murphy in all capacities for six-months, and ordered his requalification by examination. RP 14849. The sanctions are neither excessive nor oppressive, but appropriately tailored to discipline WHM and Murphy for their severely defective supervision.

The Applicants provide only one overarching argument that the sanctions as a whole were punitive, rather than remedial, because no party in this case was damaged or injured. Br. 47. Applicants misunderstand the scope of a thorough sanctions analysis. The Securities Act registration requirements are "a keystone of the entire system of securities regulation, and set forth basic requirements for the protection of investors." *Sirianni v. SEC*, 677 F.2d 1284, 1289 (9th Cir. 1982). The magnitude of the WHM's unlawful sales in dollar amount and volume, and corresponding supervision failures by the Applicants, created the potential for significant harm to investors.

In any event, the extent of harm is only *one* factor considered in tailoring appropriate sanctions. *Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 11). Sanctions can be imposed based on any other principal consideration, including the level of the offensive conduct. *See generally id.* (listing multiple factors adjudicators must consider in determining appropriate sanctions for all violations). That there was no injury or harm to a party or customer in this case, does not reduce the seriousness of, or the extensive aggravating factors

accompanying, WHM's and Murphy's misconduct. *See ACAP Fin., Inc. v. SEC*, 783 F.3d 763, 769 (10th Cir. 2015) (noting there are several balancing factors when fashioning remedial sanctions, including the seriousness of the offense); *Midas Sec., LLC*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *64 (Jan. 20, 2012) (imposing correlative sanctions for serious supervisory and supervisory system failures concerning unregistered sales of securities).

The sanctions imposed against the Applicants, which are neither excessive nor oppressive, remedially address the gravity of their misconduct while deterring the Applicants and others from engaging in sales of unregistered securities and failing to supervise such sales. The Commission should sustain the NAC's sanctions.

V. CONCLUSION

The record fully supports the NAC's findings of violation. The Commission therefore should sustain FINRA's decision in all respects.

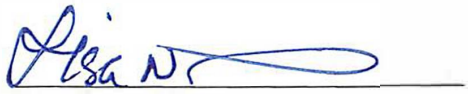
Respectfully submitted,

Lisa Jones Toms
Assistant General Counsel
FINRA
1735 K Street, NW
Washington, DC 20006
Tel.: (202) 728-8044

Dated: February 19, 2019

CERTIFICATE OF COMPLIANCE

I, Lisa Jones Toms, certify that the foregoing FINRA's Brief in Opposition to the Application for Review (File No. 3-18895) complies with the length limitation set forth in SEC Rule of Practice 450(c). I have relied on the word count feature of Microsoft Word in verifying that this brief contains 13,649 words.



Lisa Jones Toms
Assistant General Counsel
FINRA
Office of General Counsel
1735 K Street, NW
Washington, DC 20006
(202) 728-8044 Telephone

February 19, 2019

CERTIFICATE OF SERVICE

I, Lisa Jones Toms, certify that on this 19th day of February 2019, I caused a copy of the foregoing FINRA's Brief in Opposition to the Application for Review (File No. 3-18895) to be sent via messenger to:

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Room 10915 – Mailstop 1090
Washington, DC 20549-1090

and via overnight delivery to:

Dawn R. Meade, Esq.
Ashley M. Spencer, Esq.
Bonnie Spencer, Esq.
The Spencer Law Firm
Executive Plaza West
4635 Southwest Freeway, Suite 900
Houston, TX 77027

Service was made on the Securities and Exchange Commission by messenger and on the Applicants by overnight delivery service and electronic mail due to the distance between the offices of FINRA and the Applicants.

Lisa Jones Toms
Assistant General Counsel
FINRA – Office of General Counsel
1735 K Street, NW
Washington, DC 20006
(202) 728-8044 Telephone

Financial Industry Regulatory Authority

Lisa Jones Toms
Assistant General Counsel

Direct: (202) 728-8044
Fax: (202) 728-8264

February 19, 2019

BY MESSENGER

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Room 10915
Washington, DC 20549-1090

RE: In the Matter of the Application for Review of William H. Murphy & Co., Inc. and William H. Murphy
Administrative Proceeding No. 3-18895

Dear Mr. Fields:

Enclosed please find the original and three copies of the Brief of FINRA in Opposition to Application for Review in the above-captioned matter.

Please contact me at (202) 728-8044 if you have any questions.

Very truly yours,

Lisa Jones Toms

Enclosures

cc: Ashley M. Spencer, Esq.
Dawn Meade, Esq.
Bonnie Spencer, Esq.