UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
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In the Matter of the Application of

WILLIAM H. MURPHY & CO., INC. and
WILLIAM H. MURPHY

For Review of Disciplinary Action Taken by

FINRA

REPLY BRIEF

March 5, 2019

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	§	**NO. 2012030731802**
WILLIAM H. MURPHY & CO., INC.	§	
(CRD No. 27274),	§	
	§	
and	§	**HEARING OFFICER - MAD**
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REPLY BRIEF

RESPONDENTS William H. Murphy & Co., Inc., and William H. Murphy (together herein "WHM") file this Reply Brief.

I. ARBITRARY AND CAPRICIOUS

National Adjudicatory Council ("NAC") and FINRA disregard material facts, uncontroverted evidence and testimony from all seven witnesses. Arbitrary and capricious review focuses on whether an agency articulated a rational connection between the facts found and the decision made."[1] "Webster's Third New International Dictionary defines 'arbitrary' as 'based on random or convenient selection or choice rather than on reason or nature.' The adjective 'capricious' is defined as 'not guided by steady judgment, intent or purpose; lacking a standard or norm; marked by variation or irregularity; lacking a predictable pattern or law.'[2] NAC arbitrarily applied SEC rules and regulations to this case.

A. NAC AND FINRA IGNORE UNCONTROVERTED EVIDENCE AND FABRICATE FACTS.

1. NAC and FINRA Disregard The Panel's Finding That A Cooling Off Period Exists and WHM Satisfied It.

[1] *ExxonMobil Pipeline Co. v. United States DOT*, 867 F.3d 564, 571 (5th Cir. 2017).
[2] *United States v. Chromalloy Am. Corp.*, 158 F.3d 345, 353 (5th Cir. 1998).

NAC fails to discuss how WHM's cooling off period(s) affects the general solicitation violation analysis.[3] This was the central focus of the FINRA enforcement hearing.[4] The Hearing Panel ("Panel") found WHM "satisfied a waiting or cooling off period."[5] Now, NAC and FINRA argue that there was no cooling off period. NAC states, "WHM and Murphy, *attempted* to establish a 'cooling off' off period."[6] FINRA argues "WHM and Murphy *purportedly* utilized a 30 day cooling off period before the sales in the Affiliated Private Offerings were made."[7] There was no "purported" or "attempted" cooling off period, there **was** a cooling off period and WHM satisfied it.

In support of the argument that there was no cooling off period, FINRA argues WHM "had no documented procedures establishing when that period began or ended."[8] NAC states WHM "had no procedures and controls... failed to establish written procedures to address that business activity."[9] However, these statements are misleading because not having written procedures does not show that a cooling off period did not exist.

Worse, NAC and FINRA are making a false statement because WHM had documented procedures establishing the cooling off period's beginning and ending.[10] Also, the cooling off periods for each prospective investor was tracked in LREA and WHM's CRM system.[11] Witness testimony shows that these cooling off periods were understood and implemented.[12] Furthermore, the DOE's only witness produced a summary exhibit that documented what

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[3] FINRA's Brief in Opposition To Application For Review, p. 14, herein after referred to as "Opposition Brief."
[4] RR 00008, RR 7261:6-25, 7284:5-7, 7790:11-7791:12, 6704:2-9, 7018:24-7019:6, 6257:5-25, 6271:15-22, 6089:20-21, 6412:21-23, 6547:4-25, 6829:18-22, 6958:15-25, 6975:16-20.
[5] RR 013983.
[6] RR 14838, ¶ 5, (emphasis added).
[7] Opposition Brief, p. 14, (emphasis added).
[8] Brief in Opposition To Application For Review, page. 14.
[9] RR 14838, ¶ 5.
[10] RR 10478, §3.2.3; 10479 §§3.3.2, 3.3.4; see also, Opening Brief, page 33-34.
[11] RR 6816:1-15, 6271:15-25, 10298, row 45; 10022 column BY; 10023 columns CG and CH, 10030, 10031, 10038, 10054-10055, 10062, 10070, 10086, 10094, 10102, 10118, 10119, 10126, 10127, 10142, 10143, 10158, 10159, columns BY, CG and CH.
[12] RR 6257:5-17, 6271:15-25, 6816:1-15, 6818:21-25, 7260:21-7261:25.

FINRA believed were the dates of the cooling off period.[13] Despite the overwhelming evidence that a cooling off period existed, NAC and FINRA seek to confuse the SEC by disregarding the Panel's finding that a cooling off did exist and WHM satisfied it.

2. NAC and FINRA fabricate the Fact That LREA Referred Participants to Private Offerings at the End of a Seminar and Ignore Panel's Finding That No Securities Were Discussed By LREA.

Worse NAC and FINRA fabricated a fact that at the end of each seminar attendees were given an opportunity to speak with a WHM representative about "investing in LREA's affiliated offerings."[14] There is **NO** evidence supporting this conclusion. The evidence cited by FINRA, "RP 719" is part of the DOE's pre-hearing brief and "RP 14825" is part of the NAC Decision. "RP 14825" cites to no evidence. "RP 13981" is part of the Panel's Decision which does not find that the "attendees were given the opportunity, if interested, to speak with a WHM representative about investing in LREA's affiliated offerings" as FINRA argues.[15] Furthermore, there is no evidence that LREA is affiliated with any issuer. There is only evidence that all entities relevant in this case are completely separate and distinct legal entities.[16] There is no "LREA affiliated offering." This is a fabricated fact.

The witness testimony regarding the contact information sheet actually states "[s]o on their contact information form, they could indicate that they wanted more information. They could check a box that said, 'I want more information.'"[17] This testimony was referring to the document "Contact Information" where there is a section that a client can answer "[d]o you want additional information?"[18] There is no evidence that any LREA student/attendee received any

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[13] RR 10305, CX-180.
[14] RR 14838; Opposition Brief, page 11.
[15] Although the Panel's Decision find that they could discuss passive investment opportunities, those passive investment opportunities include purchasing a flipping single family homes, renting single family properties. See footnote 32 discussing "passive investment" as defined in the real estate industry.
[16] RR 10391-10395, 10411, 10425-10427, 10435-10439, 10529, 10547, etc.
[17] RR 6174:2-4.
[18] RR 12371.

information about any issuer offerings at the time of the seminars, radio shows or workshops. NAC and FINRA's argument that at an LREA workshop attendees were given information on issuer offerings is completely false and there is **ZERO** evidence to support this finding/argument. Also, this argument/finding is contrary to the Panel's finding that no seminar, radio show or public communication discussed issuer information or a specific private offering.[19]

3. NAC and FINRA Ignore All of WHM's Protective Measures In Their General Solicitation Analysis.

NAC fails to acknowledge that **no** private offering information or material was discussed, distributed or mentioned to anyone until a prospective investor passed three tiers of scrutiny, were found qualified and sophisticated, a cooling off period expired and a substantive relationship between WHM and the prospective investor was formed. This limited access to private placement and issuer information is a critical factor when evaluating a general solicitation. Because it is undisputed that no one had access to private placement information until those protective measures were met, the private offerings were actually private and no general solicitations occurred. Yet, NAC and FINRA's Opposition Brief fail to acknowledge or discuss how these undisputed facts affect the general solicitation analysis.

4. NAC and FINRA Use Old Documents And Scripts From LREA's Broker Dealer Application Despite Uncontroverted Evidence That Such Documents Were Never Used.

NAC and FINRA fail to acknowledge that LREA's business model changed from its original broker concept to an educational entity with a referral arrangement with WHM. NAC and FINRA argue that LREA's sole purpose was to solicit investors and sell securities.[20] To support this argument, NAC and FINRA rely on documents from LREA's New Membership

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[19] RR 13978.
[20] Opposition Brief, p. 9-10, RR 14819.

Application ("NMA") submitted to FINRA,[21] but withdrew when it changed its business model. This change and the unused "sales pitch" language is supported by uncontroverted testimony from **all** witnesses. Mindy Price testifies that the scripts were never used and that the specific securities related language, including the "sales pitch" language, was never used.[22] "I never spoke of a specific investment ever."[23] NAC and FINRA have no impeaching evidence that Price or anyone actually used "sales pitch" language on any radio show, workshop or seminar and there is no evidence to impeach her testimony. Yet, NAC and FINRA rely heavily on unused scripts and the "sales pitch" language from the NMA documents.[24]

Exhibit JX-5 was also never used. It was LREA's original business plan, a broker-dealer. JX-5 was submitted with LREA's NMA and was not part of LREA as an educational-networking business plan.[25] Yet, NAC and FINRA rely heavily on JX-5 even though Price testifies that JX-5 describes LREA's broker business model when LREA was going to be a broker. Because LREA withdrew its NMA and its business plan, JX-5 was never used. Even FINRA's primary investigator, Eric Beck's investigation notes, corroborate that JX-5 and JX-67 were never used. One investor told Beck that the "[s]eminar was very general, basic"[26] and provided no evidence that any sales pitch language was used in LREA's radio shows or seminars. Beck even stated that all the red flags he found were "false positives."[27]

NAC and FINRA again use part of an old script in attempt to show that LREA is an affiliated company that offer's multi-family opportunities and that LREA's vice president stated

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[21] LREA submitted a New Membership Application ("NMA") with FINRA in 2010 which was questioned by FINRA because of LREA's compliance officer's lack of experience in private placements. LREA submitted its business model, advertising scripts and other documents to FINRA during this NMA process. However, LREA withdrew its NMA and never used the business model, scripts and documents that were submitted with the NMA.
[22] RR 6130:15-6131:13, 6137:21-25, 6140:21-1644:1, 6140:21-6142:22, 6146:1-23, 6155:11-6156:12.
[23] RR 6089:5.
[24] Opposition Brief p. 10.
[25] RR 6075:8-6077:8.
[26] RR 11686, 11690.
[27] RR 7518:8-10, 7448:15-22, 7450:4-9.

in his speed that "if you have $50,000 or more... we recommend speaking with a registered rep of our 3rd party broker-dealer to see if multi-family is suitable for you."[28] There is no evidence that this speech was actually given.

There is no evidence that any of these scripts/speeches were actually given. WHM heavily redacted all speeches and scripts to ensure that no sales pitch language was used. Brian Lee, LREA's online web designer, was severely restrained in what material he could use because of WHM's severe limitations on advertising and marketing material. FINRA's own investigator, Eric Beck, questioned some LREA attendees and determined that this type of sales language was never used and Beck ultimately determined that everything WHM and the witnesses were saying was true.[29] Thus, FINRA and NAC use of the old and unused scripts is not credible evidence because there is no evidence indicating they were actually used.

5. NAC and FINRA Ignore Uncontroverted Evidence And Testimony Regarding LREA's Business Purpose.

Price testified that LREA's purpose was to be an educational entity, to build a brand as an educational entity and eventually begin to start charging for the educational classes.[30] She also testified that referring clients to WHM was a secondary purpose.[31] Price discussed how LREA's educational classes and seminars included a variety of topics, including, but not limited to, real estate investing,[32] single family home ownership, hiring a management company, flipping multi-family and single family homes, working with contractors, developers, engineers, commercial

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[28] RR 14825.
[29] RR 7524:3–7537:14.
[30] RR 6779:4-19, 6138:3-7, 6322:17-23, 6323:17-20, 6182:22-6183:6, 6783:6-15; 6193:11-13, 6162-6127, 6128:17-25, 6144:2-25, 6145:1-23, 6783:6-15, 6787:23-25, 6185:24-25, 6186:1, RX-61, p. 1, RX-112, RX-104, RX-180.
[31] RR 6779:4-19.
[32] Passive investments include all types of investing, from single family homes, to partnerships in multi-family real estate to hiring a management company to manage properties for the owner-investor. RR 6097:12-21, 6098, 6096, 6109, 6158, 6145, 6151, 6143, 6130, 6132, 6126-28, 6117, 6118, 6113, 6102, 6135, 6117, 6096-6100, 6081, 6077, 6069, 6060, 6058. Price testified, "a person, if they buy a house and they get into apartment complex, if they buy a duplex, they can hire a management company. And that's still... passive income. You're not actively running and fixing things. You hire a company....That's still a passive investment" RR 6783:4-15.

owners and multi-family owners, selling real estate through owner financing, single and multi-family investing, management and marketing, performing due diligence, rehabilitating properties, understanding financial statements, and general market data and trends.[33] Price stated that, "the workshop's intent was to educate any investor so that they could be successful hopefully in whatever real estate investment they chose" whether it be single family investments, multi-family or whatever.[34] Price explained how "investing in real estate" includes many categories of investing, from single family ownership, to being a landlord, to owning a percentage in an apartment complex, to owning multi-family properties, etc.[35] Price testified, "[w]e talk[ed] about real estate in general, not just multifamily."[36] Price never discussed a specific investment.[37]

Mark Hutton corroborates Price's testimony.[38] Hutton testified that LREA would develop a membership and networking program for industry participants to create a networking vehicle for vendors, contractors and other industry members and eventually charge for that membership.[39] Real estate industry members, like contractors, could speak at LREA seminars for advertising purposes. Also, those who were interested could sign up for the Steve Burgess workshop through his website and through LREA.[40] Gary Blumberg testified that LREA wanted to compete with Lifestyles, a similar networking-educational entity that is incredibly profitable

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[33] RR 6783:6-15, 6193:11-13, 6162-6127, 6128:17-25, 6144:2-25, 6145:1-23, 6783:6-15, 6787:23-25, 6185:24-25, 6186:1, 6158:21-6162:2, 9320:15-19, 9321:7-9322:2, 9329:2-8, 22-9330:13, 9335:14-9336:4, 9350:1-12, 9360:7-9, 9360:22-9361:1, 9363:23-9364:9, 9369:18-23, 9370:8-15, 9376:15-25, 9377:21-9378:7, 9381:18-9382:8, 9382:16-23, 9388:12-9389:14, 10465, 10909, 10883, 11023.
[34] RR 6185:21-6186:1.
[35] RR 6097-6096, 6109, 6158, 6145, 6151, 6143, 6130, 6132, 6126-28, 6117, 6118, 6113, 6102, 6135, 6117, 6096-6100, 6081, 6077, 6069, 6060, 6058.
[36] RR 9279:4-10, 9281:12-19, 9282:5-14, 9288:4-23, 9306:9-24, 9307:9-9308:4, 9313:4-17, 9314:5-9315:5, 9317:12-19.
[37] RR 6089:5-16, 6812:19-23. William Murphy made sure that nothing was discussed in the workshops could be considered prepping someone for an offer. RR 7162:18-21.
[38] RR 6806: 1-14, 6994:4-23, 6806:21-25, 6812:19-23.
[39] RR 6808:1-8.
[40] RR 9391:18-9392:10, 9392:21-9393:11, 9395:23-9396:2.

in Houston, Texas.[41] However, Blumberg **did not** want to be an educator and resigned as LREA's president because LREA was an educational entity, not a broker.[42] Blumberg testified that LREA would make money by eventually charging participants.[43] Brian Lee, the web page and online advertising developer, testified to LREA's educational purpose, its intent to build a brand as an educational entity, teach many topics, charge participants fees and develop a networking program.[44] LREA began to charge clients for its educational services.[45] Additionally, there was an educational seminar regarding the Fair Housing Act.[46] Why would an educational entity whose only purpose was to recruit investors for private placements conduct an educational seminar regarding the Fair Housing Act? Again, FINRA and NAC are attempting to mislead the SEC regarding LREA's purpose by ignoring uncontroverted witness testimony and evidence.

Despite the overwhelming evidence that LREA was an educational-networking entity, with a WHM referral agreement, FINRA argues and NAC determined that LREA's only purpose was to condition the market as part of a marketing campaign.[47] NAC and FINRA provide no reason or evidence showing how the witnesses' testimony is not credible or why they do not rely on the evidence. NAC and FINRA provide no impeachment evidence and no contrary evidence. In fact, 6 of the 7 WHM witnesses are non-interested parties, making them more credible. By not accepting their testimony as truthful evidence infers that the Panel and NAC determined they all lied under oath and subjected themselves to perjury. This is simply not logical.

6. The Witnesses Are Credible And Honest And Their Testimony Is Uncontroverted. No Impeaching Evidence Was Offered At The Hearing, Yet Their Testimony Is Not Honored.

a. Mindy Price

[41] RR 7604: 4-21.
[42] RR 7611:19-7612:20.
[43] RR 7613:19-25.
[44] RR 7613:13-18, 7643:12-25, 7645:4-7650:3.
[45] RR 7646:1-13.
[46] RR 10895-10901.
[47] RR 14826, Opposition Brief, p. 9.

Mindy Price grew upon Angleton, Brazoria County, Texas, and attended Alvin Junior College majoring in Radio-TV Broadcasting.[48] While in college, she worked as an apartment manager and became interested in the industry, so she researched, studied and trained for the industry.[49] A self-starter, she was promoted to marketing and training within three months.[50] She continued working in the industry and expanded her skills to advertising and training for smaller companies regarding how to lease apartments. She worked for Trammel Crow in Dallas where she was responsible for over 200 associates training them on the Trammel Crow curriculum.[51] She worked for the Oaks Group, specializing in helping companies find homes for employees who were moving into the Houston market, ensuring that international employees had all the residency paperwork.[52] Later, Price worked for the Houston Apartment Association for four years, where her duties required interaction with all members, owners, managers, vendors in a variety of positions that required her to forge and maintain relationships within the industry.[53] Price met Trey Stone, for whom she worked at LREA, in her capacity working for and with the Houston (HAA), Texas (TAA) and National (NAA) Apartment Associations.[54] Mindy Price testified that, in her capacity teaching classes for LREA, it was important for her to have the knowledge she gained in her past positions, which included being Director of Supplier Services for the HAA.[55] Price is a member of the NAA Education Institute Faculty and teaches a number of their certification courses,[56] Price detailed her work history, culminating in 14 years of experience at the time she was hired to run the education portion of LREA and, since LREA was

[48] RR 6470:21-6471:10.
[49] RR 6471:14-6472:15.
[50] RR 6472:16-23.
[51] RR 6472:16–6474:16.
[52] RR 6475:2-15.
[53] RR 6475:16–6477:4.
[54] RR 6477:5-8.
[55] RR 6478:12–6479:15.
[56] RR 6480:9-24.

at the time applying to be a broker-dealer, obtained her FINRA licensure.[57] Mindy Price worked in capacities where she was in a position of trust, shouldered a great deal of responsibility, dealt with pressure and long work days. Not a single bit of evidence was offered to impeach her or otherwise discredit her testimony. Yet, the Panel and the NAC found her not credible when she explained documents and events.

b. Marc Hutton

At the time of the initial hearing in this matter, Marc Hutton was a registered compliance officer with BBVA Compass' broker dealer BSI Securities.[58] For over 10 years prior to becoming the compliance officer for Murphy and LREA, Hutton was licensed and worked in the securities industry in one capacity or another.[59] He started working as a compliance analyst in 2004 and became a chief compliance officer in 2009.[60] As a compliance officer, he has an absolute responsibility to ensure that registered representatives comply with FINRA Rules and securities laws. No evidence was introduced at the hearing to show that Hutton had ever been disciplined or even had a complaint lodged against him. No witnesses were called who testified that Hutton didn't know how to do his job or performed poorly at any of his prior positions. A compliance officer position is one of great responsibility because compliance is one of the gatekeepers to protect the public from unscrupulous business practices. Yet, the panel found him to be not credible in his testimony before the panel.

c. William H. Murphy

William H. Murphy started his brokerage firm in 1990, where he was President and Chief Compliance officer, which titles he continued to have, in addition to COO, at the time of the

[57] RR 6482:4–6487:6.
[58] RR 6717:16-6718:1.
[59] RR 8109–8124.
[60] RR 8115.

hearing.[61] He has no complaints, no FINRA actions taken against him and utilized the services of a lawyer of renown in Texas, Dan LeGaye, to ensure that he put procedures in place to steadfastly follow the law in doing business with LREA.[62] At the time of the hearing, Murphy was 77 years old, [redacted] related thereto, [redacted].[63] [redacted] Panel.

d. Gary Blumberg

Mr. Blumberg graduated from the University of Texas with bachelor degree in business administration and accounting.[64] He is a licensed real estate broker in Texas and a CPA who worked in public accounting for nine years. After that, he worked for an apartment development business where he ran the management operations for 25 years.[65] He's been involved in the real estate business for 35 years, is a director emeritus of the HAA, on the board and a past president of the TAA and is a regional vice president of the NAA on whose board her has twice served.[66] He was awarded induction into the HAA Hall of Fame for long-term service in the industry.[67] Blumberg, as a CPA, is accustomed to owing fiduciary duties and a duty of good faith and fair dealing. He testified regarding forming LREA originally to become a broker-dealer, explained the process LREA went through during that application and his taking and passing the Series 7, 24, 28 and 63 exams.[68] Blumberg walked the Panel through every issue related to LREA's application to become a broker-dealer, including why it applied and why it withdrew its

[61] RR 7150:4-7152:5.
[62] RR 7152:14–7163:21.
[63] RR 7337:1–7342:13.
[64] RR 11986.
[65] RR 7582:18-7583:6.
[66] RR 7583:7-22.
[67] RR 7584:16-22.
[68] RR 7590:5-7591:19.

application, including but not limited to (1) FINRA's communications with him; (2) LREA's business plan; (3) how LREA would make money; (4) FINRA's principal concern with the application being lack of experience; (5) FINRA's suggestion that LREA withdraw its application and re-apply when they had more experience; (6) why LREA turned to an experienced broker-dealer to deal with securities; (7) the re-direction of LREA's business to education; (8) competition with Lifestyles; and (9) as a result of this change, he left the company because he did not want to teach real estate classes.[69] FINRA introduced no evidence to impeach Mr. Blumberg. No witnesses testified to impugn his character or veracity. Nevertheless, the Panel found him not credible.

e. Michael Schaps

Michael Schaps is a FINOP associated with Murphy for 15 years with 25 years of industry experience including consulting, compliance director, branch manager for a NYSE/FINRA firm and his then current position having worked for the LeGaye law firm for six years and working as the FINOP for seven firms.[70] At the time of the hearing, Mr. Schaps was the Director of Regulatory Compliance with the LeGaye law firm, in which position he worked with between 20 and 30 firms providing them with advice regarding FINRA rules, regulations and compliance while also reviewing the individual firms' rules and regulations. In that role, his services included preparing written supervisory procedures, supervisory control procedures, anti-money laundering testing, annual compliance meetings with continuing education programs and monitoring of continuing education programs on the regulatory and firm elements.[71] Mr. Schaps testified regarding (1) his services for Murphy; (2) the LeGaye's firm drafting Murphy's supervisory procedures; (3) how they determined the rules that should be applied at Murphy's office; (4) the adequacy of Murphy's procedures; (3) amendments to the Rules; (4) the specific

[69] RR 7591:20–7605:19; 7611:19-7612:20.
[70] RR 7736:6-22.
[71] RR 7737:5–7738:1; 11639.

issues that needed to be addressed; (5) issues of general solicitations; (6) approval/disapproval of communications; (7) cooling-off periods; (8) the standards put into place; (9) suitability issues; and (10) all issues regarding LREA's workshops and radio shows.[72] Michael Schaps is a 25 year FINRA professional. No evidence was admitted to impugn Mr. Schap's character, no complaints regarding how he did his job were admitted, no witnesses refuted his testimony. Yet, the Panel determined that he was not credible.

f. Dan LeGaye

Dan LeGaye is an attorney practicing since 1981. His specialty is securities as well as a real estate practice that dates back to his first job out of law school.[73] He is a contributing editor to Practitioner's Guide for Broker/Dealers (Thompson Reuters), has had articles published by Thompson Reuters' quarterly publications, has been a speaker for many engagements dealing with rules and regulatory compliance issues, including but not limited to the National Society for Compliance Professionals, SIPO, SIGMA and Counsel of Insurance Agents and Brokers.[74] Mr. LeGaye represented William H. Murphy and testified regarding (1) why utilizing an existing broker-dealer was a good idea; (2) his communications with Bill Murphy; (3) applicable securities issues; (4) due diligence; (5) changes to documents that LeGaye drafted and that did not accurately describe the parties' relationship; (6) the platform he designed for LREA/Murphy's business models; (7) documents provided with private placements; (8) solicitation issues; (9) breaking the chain solutions; and (10) compliance with securities laws.[75] FINRA introduced no impeachment evidence. No witnesses contradicted Mr. LeGaye's testimony. LeGaye is a member in good standing of the State Bar of Texas for over 30 years. Yet, the Panel determined that his testimony was not credible.

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[72] RR 7738:24–7754:2; 7779:2–7831:1.
[73] RR 7915:11–7916:5.
[74] RR 7916:6-7917:7.
[75] RR 7920:1–7957:4.

g. Bryan Lee

Bryan Lee is an internet marketer whose background includes content development for the Internet, Internet marketing, IT work, website creation and video content, having worked for three years for companies like Nickelodeon and True TV. He met LREA employees through his marketing work for Lifestyles Unlimited.[76] Mr. Lee testified at the hearing regarding (1) the marketing work he did for LREA; (2) how marketing works vis-à-vis online campaigns and contacting prospective students; (3) the ways in which Lifestyles makes money selling real estate classes; (4) Lifestyle's radio shows; (5) How LREA's public communications differed from LREA's; (6) the supervision exercised over his advertising activities; (7) the manner in which his communications were edited to comply with FINRA and SEC rules; and (8) LREA's efforts to compete with Lifestyles.[77] Even though FINRA initially made no timely objections to exhibits used with Mr. Lee, as required by the scheduling order, the Panel allowed objections during Lee's testimony and sustained same over untimeliness argument.[78] Mr. Lee is an advertising professional whose testimony reflected that he was severely limited in his advertising methods by the enforcement of rules and regulations. He had personal knowledge regarding LREA's business model to compete with Lifestyles Unlimited for real estate education dollars. No witnesses contradicted his testimony. FINRA could neither impeach him nor show his testimony to be false.

h. Eric Beck

In Eric Beck, the Panel FINALLY found a credible witness. Mr. Beck, a FINRA employee, testified regarding his investigation of WHM. Beck audited WHM for FINRA and admitted under cross-examination that the issues that raised red flags in the audit were "false

[76] RR 7628:18–7629:13.
[77] RR 7630:15–7698:2.
[78] RR 7651:4–7655:8.

positives" that led him to investigate LREA.[79] Mr. Beck was entitled to conduct his investigation any way he wished. He chose a sample of attendees for LREA's classes to question them regarding LREA and Mindy Price's representations in the classes.[80] Beck calculated the "cooling off" periods FINRA used in arguing this case. When questioned regarding his training to understand the cooling off period, its purpose, how it's calculated, etc., the Panel interfered with the questioning but ultimately allowed it since Beck's document was admitted into evidence. Mr. Beck ultimately testified that he was essentially self-taught on the issue.[81] The Panel was determined to prevent discussions regarding Beck's investigation, his interviews with clients, etc. but ultimately allowed some questions[82] Beck kept notes regarding his conversations with witnesses related to his investigation. He found Murphy to be cooperative on the phone and in providing the documents he requested. He found Mark Hutton to be cooperative in answering all of his questions and providing documents.[83] Mr. Beck contacted attendees of LREA's classes to ask them questions from a script he drafted. He doesn't remember how he sampled the list of attendees. Of the people with whom he spoke, he remembers no one ever telling him that any specific investments were ever mentioned in LREA workshops. He noted that "Seminar was very general, basic. Mindy Price. Rep is Bryan Upton, conducted meetings." Another attendee told Beck that he found out about LREA from the radio shows, that he wanted to invest in real estate, that his contact was Mindy Price and likely that he had attended seminars through Lifestyles Unlimited. None of his notes revealed that any specific investments were mentioned at any of LREA's seminars and Beck confirmed that, had anyone told him that an investment had been mentioned, he would have noted same. He recalls not one investor with whom he spoke who was given any information about an investment opportunity before the investor was qualified. Beck

[79] RR 7447:19–7448:22.
[80] RR 7469:9–7472:21.
[81] RR 7474:14–7483:25.
[82] RR 7496:23–7501:15.
[83] RR 7509:18–7510:22.

could remember no one attendee ever telling him that LREA discussed any particular deals with them. Beck testified that his specific purpose in calling a sample of LREA attendees was to determine whether Murphy and LREA employees were telling him the truth about the content of the classes, the lack of any information regarding potential investment opportunities and the lack of any offers of securities. After his sampling of phone calls, Beck believed that Murphy and LREA were telling him the truth.[84] While the Panel found Beck credible, it chose to believe his testimony if it was against Murphy and ignore his testimony if it was in Murphy's favor.

All of these witnesses are highly respectable and honorable. To find their testimony is not credible, when it supports WHM's arguments, without adequate justification, evidence or reason, is a miscarriage of justice.

7. NAC and FINRA Fabricate Wrongdoing When None Is Alleged.

NAC and FINRA attempt to distract the SEC by arguing that Respondents attempted to mislead the Panel, despite no allegations of fraud or wrongdoing, when WHM created the Amended Joint Client Services Agreement ("Amended Agreement").[85] Indeed, as soon as the mistake was discovered in the original Joint Client Services Agreement, the parties changed the mistake to accurately reflect the LREA-WHM referral agreement. The mistake was discovered during William H. Murphy's OTR in 2013. It is not uncommon for mistakes to be made in contracts documenting transactions. LREA, WHM and the issuers developed the business model less than two years before the Department of Enforcement's investigation began. As with every new business model, kinks will be worked out. WHM and his attorney admitted to the mistakes and admitted to correcting the mistakes to accurately reflect the agreement between LREA and WHM. WHM explained he did not create the document to mislead the Panel and that it is

[84] RR 7524:3–7537:14.
[85] Opposition Brief at p. 4, fn. 4.

appropriate to amend an agreement if there is something incorrect or untrue.[86] Dan LeGaye, the contract drafting attorney, stated that there were errors in the original agreement and he "tried to fix it"..."to reflect what actually happened."[87] These admissions are sworn testimony. There is nothing to indicate this is not what actually happened. The uncontroverted evidence establishes that as soon as the mistake was discovered, LeGaye fixed the mistake so the document accurately reflected the actual agreement.[88] Despite this uncontroverted evidence, the Panel, NAC and FINRA argues, without a scintilla of evidence, that (1) WHM tried to mislead the Panel and (2) the *original* Joint Client Services Agreement actually reflects the WHM/LREA business agreement and LREA's purpose.

8. NAC and FINRA Misstate WHM's Arguments and Positions and Misstate the Panel's Findings.

NAC states that WHM does "not contest that radio programs and workshops are communications that meet the definition of a general solicitation.[89] This is false. WHM argues that LREA's generic public communications, not "general solicitations" in violation of 502(c). NAC states that WHM "does not dispute that no pre-existing substantive relationship existed with any of the 23 investors at issue."[90] This is false. WHM established and the Panel found that there was a pre-existing relationship before the investors were introduced to the private offering materials and/or the issuer. The Panel found WHM established a substantive relationship with each of the 23 investors when they filled out the WHM new account forms.[91]

II. NAC AND FINRA IGNORE LAW, RULES AND REGULATIONS.

FINRA and NAC fail to recognize **any** of the statutory and regulatory safe harbors and protections that assist issuers and brokers in avoiding a general solicitation violation. NAC is

[86] RR 7394:3-17, 7396:3-7397:15.
[87] RR 7957:23-7960:2, 7963:10-7964:14, 7940:15-7942:19.
[88] RR 7942:9-19, 7942:22-25, 3276 and 10453.
[89] RR 14833.
[90] *Id.*
[91] RR 13998.

well aware that a general solicitation violation can be avoided by (1) a cooling off period,[92] (2) a pre-existing substantive relationship or (3) limited access to private offering materials to only those suitable and qualified, (4) generic advertisements and (5) broker-dealer relationships. [93] The Panel knew those variables were important when the Hearing Panel Judge stated:

> "we're going to have to determine if there was conditioning of the market, creating an interest, whether there was a substantial relationship, when there would have been one, what the cooling off period is, should have bene and when it should start."[94]

Ultimately, the Panel found there was a sufficient cooling off period and a substantive relationship and yet, neither the Panel nor NAC applied those facts to the general solicitation analysis. Instead, the Panel and NAC determined that "conditioning the market" is the only factor in a general solicitation analysis and provides no authority to support this application. Applying this single factor to a general solicitation analysis is an arbitrary application of securities rules and regulations. In doing so, WHM lacked fair notice in violation of the Administrative Procedure Act, 5 U.S.C. §706, because WHM had no way of knowing that a cooling off period and all the other factors of a general solicitation would not apply. Thus, the NAC and Panel's decisions arbitrary application of the factors that apply to a general solicitation analysis is arbitrary.

A. FINRA AND NAC IGNORE WHM'S COOLING OFF PERIOD.

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[92] *Bateman Eichler*, 1985 SEC No-Act. LEXIS 2918 (Dec. 3, 1985) (a 45 day cooling off period avoids a general solicitation violation); *Lamp Technologies*, 1997 SEC No-Act. LEXIS 638, *6 (May 29, 1997) (30 days is sufficient time to avoid a general solicitation violation); *Lamp Technologies, Inc.*, 1998 WL 278984 (May 29, 1998); *E.F. Hutton*, 1985 SEC No-Act. LEXIS 2917, *12-13 (Dec. 3, 1985) (The SEC only required that there be sufficient time between the establishment of the substantive relationship and the later offer so that the issuer may safely extend an offer); *H.B. Shaine & Co., Inc.*, 1987 SEC No-Act. LEXIS 2004 (May 1, 1987) ("sufficient time avoids a general solicitation violation"); *IPONET*, 1996 SEC No-Act. LEXIS 642, *2 (July 26, 1996)("sufficient time avoids a general solicitation violation").

[93] *Bateman Eichler*, 1985 SEC No-Act. LEXIS 2918 (Dec. 3, 1985); *Lamp Technologies*, 1997 SEC No-Act. LEXIS 638, *6 (May 29, 1997); *E.F. Hutton*, 1985 SEC No-Act. LEXIS 2917 (Dec. 3, 1985); *H.B. Shaine & Co., Inc.*, 1987 SEC No-Act. LEXIS 2004 (May 1, 1987); *IPONET*, 1996 SEC No-Act. LEXIS 642, *2 (July 26, 1996).

[94] RR 7462:16-19.

And, as stated in WHM's Opening Brief, and in *Lamp Technologies, Bateman, IPONET, E.F. Hutton, H.B. Shane* and many other SEC no-action letters, a cooling off period is relevant in the general solicitation analysis. In *DOE v. Rainmaker*, FINRA stated that "[i]n order to avoid a general solicitation, a sufficient amount of time to elapse after receipt and approval of an IQS prior to soliciting any specific securities offering to such prospective investor (i.e., a "cooling off" period).[95] Generally, among other factors, when a sufficient cooling off period exists, there is no general solicitation violation. FINRA and NAC fail to distinguish how WHM "satisfied a waiting or cooling off period,"[96] and still violated Rule 502(c). It is axiomatic that the Panel and NAC should have also found that WHM thus avoided a general solicitation violation.

B. FINRA AND NAC IGNORE THE DEFINITION OF AN OFFER OF A SECURITY AND ITS EXCEPTIONS AND IMPROPERLY DETERMINE THAT "CONDITIONING THE MARKET" IS THE ONLY APPLICABLE FACTOR IN A GENERAL SOLICITATION ANALYSIS.

While the 1933 Securities Act broadly defines the term "offer," there are limitations or exceptions to this broad definition. The SEC provides guidance that any public communication or advertisement which does not specifically refer, by name to the security, will not be deemed to be an offer to sell securities.[97] In this case, the Panel found LREA's generic public communications or advertisements which did not mention or refer to any private security were "offers".[98] In order to reach this conclusion, NAC and the Panel did not apply relevant SEC no-

[95] *DOE v. Rainmaker Securities, LLC*, Complaint No. 2013035059001 at *3 (AWC July 15, 2015).
[96] RR 13983.
[97] 17 C.F.R. §230.135a; see also, SEC Compliance and Disclosure Interpretations, Securities Act Rules, Question 256.33 (...if a presentation by the issuer does not involve an offer of a security, then the requirements of Act are not implicated); Question 256.23 (the use of an unrestricted, publicly available website constitutes a general solicitation and is not consistent with the prohibition on general solicitation and advertising in Rule 502(c) if the website contains an offer of securities); Question 256.24 (Information not involving an offer of securities may be disseminated widely without violating Rule 502(c)). *Bateman Eichler, Hill Richards, Inc.*, 1985 SEC No-Act. LEXIS 2918 (Dec. 3, 1985); *E.F. Hutton & Co.*, 1985 SEC No-Act. LEXIS 2917 (Dec. 3, 1985); *H.B. Shaine & Co., Inc.*, 1987 SEC No-Act. LEXIS 2004 (May 1, 1987); *IPONET*, 1996 SEC No-Act. LEXIS 642, (July 26, 1996); *Lamp Technologies, Inc.*, 1997 SEC No-Act. LEXIS 638 (May 29, 1997). RR 13677-13678.
[98] RR 13978, 13987, 13994-13995.

action letters such as *Bateman*, *E.F. Hutton*, *IPONET*, and *Lamp Technologies*.[99] Instead of addressing the relevant factors in a general solicitation analysis, NAC and FINRA state that because WHM participated in an offering at the time of the general solicitation, WHM cannot claim any exemption and SEC no-action letters are unavailing.[100]

If the definition of an offer of a security is purely the 1933 Securities Act definition, without exception and/or conditioning the market is the only factor to consider in a general solicitation analysis, then all of the public communications and advertisements discussed in *Bateman*, *E.F. Hutton*, *IPONET*, and *Lamp Technologies* should have been found to be "offers" of securities and 502(c) violations. However, the SEC did not make such determinations. Instead, the SEC instructs that **all** facts and circumstances must be evaluated, including but not limited to, a cooling off period, limited access to private placement materials, broker dealer relationships and generic advertising when making a 502(c) violation determination.[101]

For instance, the broker in *Bateman* implemented an advertising program that used seminars, speaking engagements and generic advertising as the first step in establishing a business relationship with new clients.[102] However, because the public communications were generic and did not reference or refer to any private offerings for sale, a cooling off period expired, no solicited prospective offeree had access to the private placement materials prior to establishing a substantive relationship and being found qualified and suitable, the SEC found that the seminars, speaking engagements and generic advertisements were not 502(c) general solicitations violations and were not conditioning the market.[103] The SEC did not apply the strict

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[99] *Lamp Technologies, Inc.*, 1997 SEC No-Action Letter (May 29, 1997); *E.F. Hutton & Co.*, SEC No-Action Letter, 1985 (Dec. 3, 1985); *Bateman Eichler*, SEC No-Action Letter, 1985 LEXIS 2918 (Dec. 3, 1985); *IPONET*, 1996 SEC No-Act. LEXIS 642, (July 26, 1996).
[100] RR 14832.
[101] *Id.*
[102] *Bateman*, 1985 SEC No-Act LEXIS 2918 (Dec. 3, 1985).
[103] *Id.*

1933 Securities Act definition though the broker's advertisements were an attempt to subsequently sell private securities.

Similarly, in *E.F. Hutton*, the broker was permitted to send "Pre-Offering Materials" to determine a prospective investor's interest in a private offering prior to sending the full disclosure documents.[104] Even these "Pre-Offering Materials" ***which discussed specific investments*** and were sent directly to prospective investors, with whom the broker had no pre-existing substantive relationship with, were found **not** to be conditioning the market or a general solicitation violation because of the protective measures that were in place. The same protective measures WHM implemented. In *E.F. Hutton*, the broker was clearly participating in a private offering before establishing a substantive relationship.

NAC argues that *IPONET* does not apply because "WHM did not use a generic questionnaire determining accreditation standards **before** it solicited the general public on the radio or at the workshops."[105] However, NAC misses the point of *IPONET*. *IPONET* publicly solicited people to join its website. In *IPONET*, the public advertisements included "tombstone" advertisements and ***red herring prospectuses*** by the issuers to entice the public to join *IPONET's* networking website for the purpose of recruiting private placement investors. *IPONET's* original **unrestricted** public advertisements were found **not** to be conditioning the market or a general solicitation violation.[106] At the time of the original unrestricted public solicitation, *IPONET* **did not** have any relationship with those persons publicly solicited.[107] After the initial public solicitation, people signed up for the website, filled out a generic questionnaire and those who were qualified had access to private placement materials.[108] This marketing campaign was not

[104] *E.F. Hutton*, 1985 SEC No-Act. LEXIS 2917, *6 (Dec. 3, 1985).
[105] RR 14833.
[106] *IPONET*, 1996 SEC No-Act. LEXIS 642, *6 (July 26, 1996).
[107] *IPONET*, 1996 SEC No-Act. LEXIS 642 (July 26, 1996).
[108] *IPONET*, 1996 SEC No-Act. LEXIS 642 (July 26, 1996).

considered a 502(c) violation. This same logic applies to *Lamp Technologies*.[109] The original unrestricted public communications were made to the public with the purpose of the recruit people to join the website and eventually invest in private placements. Only after those who were publicly solicited and were deemed qualified and suitable, would have access to private placement information and were allowed to invest in live offerings.

This is exactly the same marketing scenario WHM implemented. The original public communication was unrestricted. However, no one had access to private placement information until they were qualified, a cooling off period expired, passed a three tiered vetting process and after generic questionnaires were completed, etc.

NAC and FINRA miss the point of *Bateman Eichler, E.F. Hutton, H.B. Shane, IPONET* and *Lamp Technologies* regarding the "participating before the offering" by arguing that WHM cannot claim an exemption because it was participating in an offering at the time of the radio shows. Again, this logic makes no sense when applying the aforementioned no-action letters. If NAC and FINRA's logic applied to those cases, then the SEC should not have permitted the marketing campaigns in *Bateman Eichler, E.F. Hutton, H.B. Shane, IPONET* and *Lamp Technologies* because all of the broker-dealers were knew of or "participated in" the private placements before they solicited new investors. In all of those cases, the broker dealer or company knew that the offering existed at the time of the original public communication because they knew of such offering when they created a networking arrangement. Thus, according to NAC and FINRA's application, they were all "participating in an offering." However, despite the fact that the broker-dealer knew an offering existed at the very beginning of their networking or marketing arrangement, the SEC did not find those original public communications "offers" in violation of Section 5. Under NAC and FINRA's line of reasoning, if a broker-dealer knows of an offering at the time they are making a networking arrangement, any subsequent public

[109] *Lamp Technologies*, 1997 WL 282988 (May 29, 1997).

communications are considered "offers" in violation of the general solicitation ban. This is simply not the standard that the SEC has implemented over the years. Hence, NAC arbitrarily applied SEC no-action letters without any precedent.

C. FINRA AND NAC IGNORE MATERIAL DISTINGUISHING FACTS IN *PRENDERGAST, GEARHART & OTIS, INC.*, AND *KCD FINANCIAL*.

NAC and FINRA ignore the most important distinguishing facts in this case and *Gearhart, Prendergast* and *KCD Financial*. It is undisputed WHM implemented the aforementioned protective measures. In *Gearhart* and *Prendergast*, **none** of WHM's protective measures were implemented.[110] Yet, NAC and FINRA apply *Prendergast, Gearhart* and *KCD Financial* without recognizing or discussing major distinctions. In *Prendergast* and *Gearhart* fraud was the central issue of the enforcement action and there were no protective measures in place, no cooling off period, no limited access to private placement materials to only those qualified and suitable, no pre-existing substantive relationship, nothing to protect the investor. In this case there was no fraud involved and WHM implemented many protective measures to protect the investor. NAC and FINRA do not make these distinctions because acknowledging the protective measures WHM implemented would show that NAC and FINRA's interpretation of the conditioning the market theory, as applied to this case, fails.

KCD Financial is fundamentally distinguishable because the issuer's affiliated party published articles about the investment fund. The unrestricted public articles mentioned and discussed the private offering. Thus, publicly advertising about a private placement is a violation of 502(c). The facts of this case are vastly different from *KCD Financial*. No one ever knew a private offering existed until a prospective offeree was qualified; there was a cooling off period, a substantive relationship established with a broker-dealer before any prospective investor knew of any private offering, and there were only **generic** public communications that never

[110] *Gearhart & Otis, Inc.*, 42 S.E.C. 1 (1964); *Brian Prendergast*, 2001 SEC LEXIS 1533 (Aug. 1, 2001).

mentioned any private offerings. Also, as stated in the opening brief, *KCD Financial* did not implement a cooling off period, limit access to private offering information to only those qualified and suitable, there was no substantive relationship or any of the protective measures WHM put in place. Thus, without distinguishing *KCD Financial* from the facts of this case, its application and relevance to this case is completely arbitrary.

III. PRACTICAL IMPLICATIONS

Over the past few decades, the legal trend and public policy has been to reevaluate and promote cost effective access to capital for companies of all sizes because companies seeking access to capital in the U.S. markets have been overburdened by unnecessary or superfluous regulations while simultaneously protecting investors.[111] However, striking the right balance between facilitating access to capital while simultaneously protecting investors is a difficult but critical goal of the SEC.[112] The SEC has facilitated this public policy and legal theme to lessen the burdens on start-up companies attempting to raise capital by broadening the scope of permissible public communications in private securities.[113] In *Woodtrails-Seattle*, the SEC allowed a general partner of an issuer to distribute 350 written private offerings to persons with whom the general partner had already established a business relationship.[114] A few years later, *Bateman* permitted a broker-dealer's public communications to be distributed to people with whom the broker-dealer had no relationship with.[115] After that, in *IPONET*, approved a business-networking arrangement that involved generic unsolicited public advertisements regarding investment opportunities through *IPONET's* internet services even though *IPONET's* services

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[111] Letter from Mary Schapiro, Chairman, SEC, to Rep. Darrell E. Issa, Chairman, U.S.H.R. Comm. On Oversight and Gov't Reform (April 6, 2011), available at: http://www.sec.gov/news/press/schapiro-issa-letter-040611 .pdf.
[112] *Id.*
[113] *Id.*
[114] *Woodtrails-Seattle, Ltd.*, 1982 SEC No-Act. LEXIS 3288 (July 8, 1982).
[115] *Bateman-Eichler*, 1985 SEC No-Act. LEXIS 2918 (Dec. 3, 1985).

eventually lead to private offerings.[116] In *Lamp Technologies*, the SEC permitted a marketing campaign by *Lamp Technologies* to publicly advertise its services even though private offerings were later offered to those who were publicly solicited.[117]

This gradual involvement of public advertisements in the chain of sale for private investments is codified in the JOBS Act which essentially creates an opportunity for private issuers to publicly advertise directly for private offerings and use unrestricted public advertisements, so long as certain conditions are met.[118] Over the years, when in doubt, the trend is to permit the public solicitation when protective measures are implemented. However, in this case, NAC and FINRA confound securities regulations by backtracking on all of the previous securities guidance by not recognizing the progressive movement towards permitting a general solicitation in a chain of sale in a private offering, provided certain conditions are met.

IV. CONCLUSION

NAC and FINRA ignore the evidence, law and securities regulations. Any evidence, law or regulatory guidance that assists WHM's defense is flatly rejected by NAC and FINRA without explanation and replaced by speculative conclusions with no supporting evidence or authority. Thus, NAC's Decision is arbitrary and should be reversed and vacated.

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[116] *IPONET*, 1996 SEC No-Act. LEXIS 642 (July 26, 1996).
[117] *Lamp Technologies*, 1997 WL 282988 (May 29, 1997).
[118] Jumpstart Our Business Startups Act (JOBS Act), H.R. 3 606 (Apr. 5, 2012).