UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Application of: **Cantone Research Inc., Anthony Cantone, and Christine Cantone,** **For Review of Disciplinary Action Taken By** **FINRA**	**ADMINISTRATIVE PROCEEDING** **File No. 3-18999**

APPLICANTS' OPENING BRIEF IN SUPPORT OF APPLICATION FOR REVIEW

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I. FACTS RELEVANT TO THIS APPEAL

A. The Parties[1]

Cantone Research, Inc. ("CRI") is a small, family-run broker-dealer located in New Jersey.[2] It has been a FINRA member since 1990,[3] and it employed approximately 28 people as of August 2016.[4] CRI engages in a retail securities business, and offers its customers a wide range of investment products, including stocks, bonds, and private placement offerings.

At all relevant times – indeed, since CRI's inception – Mr. Anthony Cantone was the Firm's majority owner, President, and CEO.[5] He has over 30 years of experience in the securities industry.[6] Most of Mr. Cantone's customers are sophisticated, experienced investors who look to him for investment opportunities with the potential for significant returns.[7] Mr. Cantone's typical customer holds the majority of his or her wealth away from CRI, and invests only a portion of his or her assets with the Firm, seeking securities with the potential to yield lucrative returns.[8]

Mrs. Christine Cantone is the former Chief Compliance Officer ("CCO") of CRI.[9] First registered in 1996, Mrs. Cantone has extensive supervisory experience.[10] From approximately 1996 through 2004, she worked under the Firm's CCO, assisting with general compliance issues,

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[1] Together, CRI, Anthony Cantone, and Christine Cantone are referred to as the "Applicants."

[2] ROA000840.

[3] ROA006365-006412; ROA000840.

[4] ROA000840.

[5] ROA006365-006412; ROA000859.

[6] ROA006313-006364; ROA001106.

[7] ROA001106-001107.

[8] ROA001106-001107; ROA001420; ROA001430; ROA001446.

[9] ROA006424; ROA001306.

[10] ROA006365-006412; ROA001305.

regulatory filings, and other regulatory matters.[11] After an eight-year apprenticeship, Mrs. Cantone took over as CCO.[12] Throughout her tenure as CCO, Mrs. Cantone stayed current on regulatory requirements by attending continuing education courses, and by regularly reviewing FINRA publications.[13] In 2014, Mrs. Cantone resigned as CCO.[14] She remains an employee of the Firm, handling human resources matters.[15]

B. The Nursing Home/Assisted Living Private Placement Offerings Involved

Enforcement filed charges against CRI, Anthony Cantone, and Christine Cantone arising out of five private placements. The first four were to finance the construction, operation, and sale of four separate nursing home/assisted living facilities (Columbia, Chestnut, Oklahoma and Cedars), all developed by Christopher Brogdon.[16] These were not the first nursing home-related offerings that the Firm did that involved Brogdon. Applicants participated in a total of seven such offerings,[17] all of which were similar in structure, purpose, and disclosures.[18] Four of the seven offerings were profitable before Enforcement's case was even filed, with investors in those offerings receiving, at maturity/completion, the return of their principal plus interest and, in some instances, additional equity-based returns. Additionally, after the close of the hearing in this case, but before the Hearing Panel's Decision was issued, a fifth offering (which Enforcement

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[11] ROA001597.

[12] *Id.*

[13] *Id.*

[14] ROA001598.

[15] *Id.*

[16] For brevity, the nursing home/assisted living projects are collectively referred to as simply "nursing home projects" or "nursing home developments" herein.

[17] In addition to the four nursing home/assisted living facilities offerings at issue here, the Firm sold three other nursing home/assisted living facilities offerings that were not part of the Complaint: Hoover, Country Club, and Limestone.

[18] *Compare* ROA006505-006528; ROA006529-006560; ROA006579-006612; ROA006639-006678; and ROA006699-006728.

had contended at hearing was a total loss) was sold and the investors received their principal and interest in full.[19]

In total, then, five of the seven nursing home developments involving Brogdon were profitable, further bolstering Brogdon's record of successful developments and projects.

1. Offering Structure and Disclosure of Nursing Home Developments

The structure of the seven nursing home developments associated with Brogdon is nearly identical. Mr. Cantone and CRI created a limited liability company ("LLC") for the specific purpose of raising capital to fund the acquisition of a facility that Brogdon sought to acquire and develop.[20] The capital was secured by a promissory note held by the LLC, and the note was secured by the purchased property.[21] The LLC, in turn, issued Certificates of Participation ("COPs") to investors in minimum denominations of $10,000. Investors generally were entitled to 10 percent annual interest payments during development, and once the underlying property was either sold or refinanced, investors were entitled to the return of their principal, as well as their proportionate share of 20 percent of the capital gains from the sale or refinancing.[22] The principal and interest payments were personally guaranteed by Brogdon, his wife, and the Brogdon Trust.[23] Each offering was issued pursuant to a Confidential Disclosure Memorandum ("CDM"), which was drafted by the Firm's then outside counsel, Michael Gardner, an AV-rated

[19] Evidence supporting both the success of the offering and the payments to investors was added to the record pursuant to the Order dated December 23, 2016. ROA013599-013600.

[20] ROA001112; ROA001108; ROA006505-006528; ROA006529-006560; ROA006579-006612; ROA006639-006678; ROA006699-006728.

[21] *Id.*

[22] *Id.*

[23] ROA006565-006570; ROA006621-006628; ROA006683-006688; ROA006733-006738.

lawyer, and which contained robust disclosures regarding the numerous investment risks associated with each offering.[24]

2. The Four Specific Nursing Home Offerings at Issue

Despite near identical disclosures in all seven nursing home offerings involving Brogdon, the Complaint took issue with only four. For each offering, CRI and Anthony Cantone performed a detailed review of the project and its prospects for success, which included an analysis of information relating to the value of the underlying real estate, the development plan, operational potential of the facility, and projected earnings.[25] The sufficiency of that due diligence is not at issue here. Instead, the question is, regardless of the individual project being considered, or the amount of review that went into its approval for sale to customers, whether the Firm negligently failed to disclose certain negative facts regarding Brogdon or companies he was associated with in the 1990s.

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[24] ROA010467-013058; ROA001193; ROA001195; ROA001201; ROA001209; ROA001214.

[25] Hoover: ROA007413-007314, ROA007415-007416, ROA007417-007422, ROA007423-007450, ROA007451-007452, ROA007453-007458, ROA007459-007464, ROA007465-007484, ROA007485-007512, ROA007513-007516.

Columbia: ROA001113; ROA001123-001126; ROA007535-007902;

Chestnut: ROA001196-001201; ROA007911-008104; ROA008105-008106; ROA008107-008154; ROA008155-008158; ROA008159-008162; ROA008163-008164; ROA008165-008170; ROA008171-008198; ROA008199-008226; ROA008227-008234;

Oklahoma: ROA001203; ROA008235-008330; ROA008331-008430; ROA008431-008528; ROA008529-008650; ROA008651-008760; ROA008761-008946; ROA008947-009134; ROA009135-009322; ROA009323-009366; ROA009367-009378; ROA009379-009418; ROA009419-009428; ROA009429-009432; ROA009433-009436; ROA009437-009480; ROA009481-009508; ROA009509-009536; ROA009537-009564; ROA009565-009592; ROA009593-009620.

Cedars: ROA009621-009622; ROA009623-009624; ROA009625-009626; ROA009627-009640; ROA009641-009642; ROA009643-009644; ROA009645-009646; ROA009647-009654; ROA009655-009682; ROA009683-009716.

3. Christopher Brogdon

For over 25 years, Brogdon bought, sold, developed, and operated nursing homes, assisted living facilities, and retirement communities.[26] As of the relevant time period, he had spent over 20 years serving as an officer or director of several publicly-traded healthcare companies, each of which experienced substantial growth and success under his leadership. When CRI and Mr. Cantone sold the four nursing home/assisted living facilities offerings at issue, Brogdon had a proven track record of success.[27] Additionally, between 2003 and 2009, prior to any of the offerings at issue in the Complaint, CRI underwrote ten municipal offerings involving nursing home developments managed or developed by Brogdon. Each of those municipal bond deals was successful, with investors receiving the return of their principal, plus the promised interest payments.[28] Through the municipal bond deals, CRI and Anthony Cantone gained personal experience with Brogdon, and witnessed firsthand his ability to successfully develop and sell these types of facilities, often ahead of schedule.[29] CRI and Anthony Cantone considered their recent, personal experiences with Brogdon to be the most important indicia of his ability to develop these kinds of projects as planned – a pattern of conduct that would be of primary importance to a potential investor.[30]

Brogdon's resume of success is important here. The NAC determined that certain negative occurrences from either Brogdon's past, or some entity he was affiliated with, were

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[26] ROA006510.

[27] *E.g.*, ROA006510.

[28] ROA001112; ROA001108.

[29] ROA001112; ROA001108.

[30] ROA000940-000941; ROA000948-000949.

material disclosures that were negligently omitted in violation of Sections 17(a)(2) and (3).[31] The NAC concluded that these facts, discussed below, were material and should have been disclosed to investors.[32] The background facts relevant to this appeal are:

a. NHC Bankruptcy

The NAC held that a 1999 Chapter 11 (reorganization) filing by NHC, an entity of which Brogdon had been the Chairman, was a material fact that had to be disclosed to investors considering whether to purchase an interest in nursing home developments between 2008 and 2013. Specifically, the NAC found that because the CDMs included this disclosure in the description of Brogdon's background – "In 1998 and 1999, Mr. Brogdon was also Chairman of New Care Health Corporation, a NASDAQ listed company in the assisted living and nursing home business"[33] – the CDMs also needed to disclose that the company filed for bankruptcy.

b. Georgia Civil Dispute

In 1998, also while Brogdon was at NHC, the company was sued in civil court to enforce the terms of a stock repurchase agreement.[34] In 2003, the Georgia Court of Appeals issued an opinion that enforced the agreement, finding it "essentially" amounted to a personal guarantee by Brogdon to purchase the stock.[35] The NAC concluded that this 20-year old decision was material to present-day investors because the COPs at issue involved a personal guarantee by Brogdon (or his entities).[36]

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[31] ROA014220.

[32] *Id.*

[33] Ex, ROA 006536 (Columbia CDM).

[34] ROA014212.

[35] *Id.*

[36] *Id.*

c. RCA Liens

In 1996, while Brogdon was the Chairman of RCA, the IRS filed tax liens against the company. The NAC Decision found that the 1996 liens were material disclosures required in the 2008-2013 offerings because, as above, the CDMs "touted" Brogdon's success with the company and, thus had to disclose any negative facts, including the fact the IRS had once imposed tax liens.

d. NASD Bars

In 1984 and 1985, the NASD barred Brogdon from association with a member firm. Brogdon did not attend either NASD hearing and the judgments against him were entered in default.[37] Ten years after the NASD decisions, the NASDAQ approved an application by Brogdon's (then) company, RCA, requesting that he be permitted to serve as the Chairman of RCA (a publicly traded company), notwithstanding the NASD's action. Fourteen years later, as CRI began its due diligence on the first Brogdon nursing home project, it received a letter from Brogdon's counsel, explaining the circumstances surrounding the NASD proceedings. Additionally, CRI's own attorney advised that the bars were no longer relevant disclosures.[38]

The Hearing Panel, in its decision, held that these two bars were not material for two reasons: (1) their age; and (2) ten years after the bars were imposed the Nasdaq approved RCA's application for Brogdon to serve as the Chairman of RCA, notwithstanding this event. This decision was based not only on the evidence presented at hearing before the Hearing Panel, but

[37] ROA001789 and ROA001795.

[38] ROA 013391; ROA001119; ROA001601; ROA001121; ROA006803.

based on the legal authority submitted on the issue post-hearing, at the express direction of the panel.[39] The Hearing Panel concluded:[40]

> Taking all of these facts into consideration, the Panel concludes that the age of the bars and Nasdaq's approval of Brogdon's company's listing application vitiate their materiality. The record supports Respondents' contentions that [Respondent's attorney, Mr.] Gardner and Friar both knew the NASD had barred Brogdon, and in Gardner's judgment, the bars did not have to be disclosed in the CDMs for the Brogdon-related COPs. The record also supports Cantone's testimony that he did not hide Brogdon's bars from inquiring customers; for example, one customer confirmed that he and Cantone discussed these negative events, and Cantone sent him a copy of the letter from Brogdon's attorney explaining the negative information.
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> For these reasons, we conclude that there is not a substantial likelihood that a reasonable investor, deciding whether to invest in the COPs, would find disclosure of the 1984 and 1985 NASD bars to significantly alter the total mix of available information. Therefore, failure to disclose them was not a material omission.

The NAC reversed these conclusions, without citation to any legal authority.

C. Extension Agreements for Columbia and Oklahoma

When the notes for Columbia and Oklahoma came due, the projects were either not completed, had low occupancy, or otherwise were not operating at the level originally hoped. This impacted not only the manager's ability to sell or re-finance the property (the triggering events for investor repayment), but also the project's ability to make its interest payments.

At the time the Columbia note was supposed to mature, the project was not yet complete. Columbia LLC, through Mr. Cantone, entered into two extension agreements – one in October 2012 and one in January 2013 – that pushed the maturity date back.[41] In each case, Mr. Cantone informed investors of the agreements, and gave them the option of selling back their investments

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[39] ROA 013713-013714.

[40] ROA 013715.

[41] ROA002811-002812; ROA009903-009904; ROA001187-001188.

at cost if they did not wish to continue under the extended terms. Mr. Cantone provided this option because he did not want investors who desired immediate access to their funds to be impacted by the project's delay (even though the possibilities of delay/failure were disclosed in the CDM).[42] Eventually, despite the project's delays, the Columbia project was sold, as initially hoped. The investment ended up being **profitable** for its investors.[43]

Similarly, when the Oklahoma note came due in July 2013, the Oklahoma LLC, through Mr. Cantone, extended the note by six months to January 2014.[44] As he did for the Columbia investors, Mr. Cantone informed the Oklahoma investors of the extension, and gratuitously gave them the option of selling back their investments at their cost.[45]

The NAC concluded that these extensions were made in connection with purchases and sales of securities,[46] thus triggering an obligation to disclose that Brogdon had failed to make timely interest payments and that the Cantones were covering the missed and late payments.[47] The NAC further concluded that these disclosure failures were made with scienter.[48]

D. The Cherokee Offering

In May 2013, CRI participated in the Cherokee Offering.[49] This project was not a nursing home development, nor was it guaranteed by Brogdon personally.[50] Instead, Cherokee is

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[42] ROA001218.

[43] ROA 013599-013603.

[44] ROA004147-004152.

[45]ROA001218.

[46] ROA014214.

[47] *Id.*

[48] ROA014220.

[49] Cherokee Financial LLC is the name of the entity that issued the COPs. In the record, the project is sometimes referred to as "Cherokee" and sometimes referred to as "Conyers."

[50] *Id.*

a residential real estate development in Conyers, Georgia. The private community has 108 single family townhomes, a club house, and multiple amenities.[51] The development and construction of the project was the responsibility of Bruce Alexander, an accomplished real estate developer.[52] Prior to selling the Cherokee offering, Mr. Cantone personally visited four of Alexander's other developments to assess the quality of his work.[53] It also is notable that Mr. Cantone had been involved with two prior real estate developments involving Alexander.[54] In addition to the site visit, the Firm collected a substantial amount of information on the Cherokee project and Alexander prior to selling the offerings.[55]

With regard to Cherokee, the NAC made three primary conclusions. *First*, it concluded that the four negative background facts regarding Brogdon (bankruptcy, lien, civil case, NASD) were material facts requiring disclosure to potential investors, even though Brogdon was not managing the Cherokee development, did not personally guarantee Cherokee, and Cherokee did not involve nursing homes (i.e., the factual reasons the NAC concluded these negative facts were material to the nursing home projects).

Second, the NAC concluded that missed interest and late payments on prior Brogdon-guaranteed nursing home projects were material facts requiring disclosure in Cherokee, even though it was not Brogdon-guaranteed.

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[51] ROA006749-006774.

[52] ROA 6758-6759. Alexander's company is Lifestyle Homes of Distinction, the "Developer" as defined in the CDM. ROA006756-006758. Alexander has been developing housing communities, like the one at issue, since 1995, and he has built similar communities, ranging in size from 40 to 220 homes, with aggregate home sales of over $100 million. *Id.*

[53] ROA001257-001258.

[54] ROA001258-001259.

[55] ROA009717-009730; ROA009731-009732; ROA009733-009760; ROA009761-009764; ROA009765-009766; ROA009767-009770; ROA009771-009830; ROA009831-009834; ROA009835-009836; ROA009899-009900; ROA009865-009866; ROA013059-013076.

Third and finally, the NAC concluded that these omissions were made with scienter, sufficient to establish a claim for 10(b)-5 fraud.

II. ISSUES PRESENTED ON APPEAL

A. Materiality

The vast majority of this appeal centers on materiality a required element of Enforcement's claims under Section 17(a), Section 10(b), and Rule 10b-5.[56] A fact is material if it is "substantially likely" to "significantly alter" the "total mix" of information available to an investor contemplating an investment purchase.[57] "Whether or not a particular description, representation, illustration, or other statement involving a material fact is misleading depends on evaluation of the context in which it is made."[58]

The "total mix" element ensures that no one fact is afforded improper focus and, instead, that the value of each fact is considered in light of all information presented. Thus, each fact must be viewed in the context of the voluminous information CRI collected, as part of its due diligence on each project and offering, a substantial amount of information on the underlying properties, including property appraisals, environmental assessments, historical financials, market demand for nursing/assisted living services, and more.[59] This extensive due diligence evidences that CRI thoroughly evaluated each project and its likelihood of success, and that it reasonably believed in the success of each offering, thereby negating an inference that it acted recklessly in failing to focus on the particular (and often distant) facts at issue here. Beyond

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[56] 15 U.S.C. § 78j.

[57] *Basic Inc. v. Levinson*, 485 U.S. 224, 239 (1988) (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

[58] 17 C.F.R. § 230.156(b).

[59] *E.g.*, ROA007451-007452; and ROA002811-002812; ROA009903-009904; ROA001187-001188; ROA007537-007750; ROA001124.

that, this due diligence reflects the amount of information that was collected actually relating to each project.

Further, "if it is questionable whether a fact is material, or its materiality is marginal, that tends to undercut the argument that defendants acted with the requisite intent or extreme recklessness in not disclosing the fact."[60] That is, the more questionable the materiality, the less likely the individual acted recklessly in failing to disclose it.

B. The Four Dated Background Facts Regarding Brogdon Are Not Material

Materiality is an element of an omissions claim brought under Section 17(a) and Rule 10b-5.[61] The failure to prove that an omitted fact is material is fatal to such claims. "[T]o fulfill the materiality requirement 'there must be a *substantial likelihood* that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[62]

1. NHC's Bankruptcy is not Material

With regard to NHC's 1999 Chapter 11 filing, the NAC concluded that it was material because the CDM "[relied] on [Brogdon's] Chairmanship of NHC as evidence of his nursing home business-related expertise."[63] The "emphasis" on his role at NHC, the NAC concluded, gave rise to the materiality of the bankruptcy filing.[64] This finding should be reversed for three reasons.

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[60] *City of Dearborn Heights v. Waters Corp.*, 632 F. 3d 751 (1st Cir. 2011).

[61] 15 U.S.C. § 78j.

[62] *Basic*, 485 U.S. at 239.

[63] ROA014211.

[64] *Id.*

*First, i*n determining whether this fact – or any fact – is material, the fact must be examined in context.[65] Here, the discussion of NHC in the CDM is confined to a single sentence in the midst of Brogdon's biography, and is limited to a recitation of the company's name, its industry, his title and the years he held that position. There are no proclamations of success. There is not even a recitation of events that happened under his chairmanship of NHC that could be construed as representations of success. In short, the simple statement that Brogdon served as NHC's Chairman was not a "positive" fact that needed to be mitigated by countervailing "negative" facts. It is merely a recitation of his professional experience. Most important, it was not, as the NAC erroneously concluded, "emphasized."[66] The materiality finding should be reversed for this reason alone.

Second, the duty of disclosure in this instance only arises when an "omitted fact was necessary to render a preexisting statement not misleading."[67] Here, the "preexisting statement" that Brogdon was the Chairman of NHC is not misleading in any way and, in turn, there arose no obligation to "cure."[68]

Third, the NAC's finding of materiality on this item should be overturned because the legal authority cited in support of the finding actually compels the opposite result. *SEC v. Merchant Capital,* for example, held that the personal bankruptcy of the co-founder/co-operator of the company was material because the company had "put his experience at issue by touting, in great detail, [his] business experience."[69] The 11th Circuit concluded that the bankruptcy was

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[65] 17 C.F.R. § 230.156(b).

[66] ROA014211.

[67] *Thompson v. RelationServe Media, Inc.*, 610 F.3d 628, 681 (11th Cir. 2010).

[68] *Id.*

[69] *S.E.C. v. Merch. Capital, LLC*, 483 F.3d 747, 771 (11th Cir. 2007).

material because it would have assisted an investor in assessing the quality of that specified experience. As stated above, the CDMs at issue here neither "emphasized" nor "touted" Brogdon's experience at NHC – they merely mentioned that he had held the position.

Also differentiating is the fact that *SEC v. Merchant Capital* involved a personal bankruptcy.[70] There are many reasons that a company could file Chapter 11. Some reasons could implicate the current management of the company (i.e., suggest that the management skills were subpar or otherwise questionable). On the other hand, a company could file Chapter 11 for business reasons, to deal with decisions from prior management, etc. In any event, the mere fact of the Chapter 11 filing, without more, does not give rise to any inference whatsoever specific to Brogdon or his ability to do his job, let alone the suggested inference (that Brogdon's leadership caused the bankruptcy). Nor did Enforcement, which carried the burden of proving materiality, introduce any evidence to support its suggested inference of materiality. As a result, the materiality finding should be reversed.

Moreover, there is ample authority showing that a 20-year-old bankruptcy is not a material fact requiring disclosure under the circumstances presented here.[71] Numerous courts

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[70] In the case of a personal bankruptcy, there is, arguably, a plausible inference that, if proven, suggests the individual declaring bankruptcy did so because of poor financial decisions. In such a circumstance, a personal bankruptcy could be considered material. To draw that same inference, however, from a corporate bankruptcy (and a Chapter 11 bankruptcy no less), without any corroborating facts connecting the filing to a particular individual, is simply improper.

[71] *Fisher v. Ross*, 1996 WL 586345, (S.D.N.Y. Oct. 11, 1996) ("In this case, the plaintiff has alleged that the prior employment of four directors and executive officers at Magic, more than six years before the Offering, is material. But the conclusory allegation is unsupported by any specific facts. The bankruptcy at issue occurred more than six years before. There is no evidence proffered to indicate that there was anything about the bankruptcy of Magic that was related to the financial condition or prospects of Ilio at the time of this offering. There is no evidence presented that the individual defendants committed any wrongdoing at Magic, and there is no statement in the Prospectus about the specific directors that is in any way false or misleading."); *Feinberg v. Leighton*, No. 80 CIV. 4398 (MGC), 1987 WL 6147, at *12 (S.D.N.Y. Jan. 30, 1987) ("In addition, I find that Leighton's alleged "omitting" to tell Feinberg that he had previously been involved in a company that went bankrupt cannot be considered to be so material that a reasonable investor would not have made the investment in Compu-Com had he known of that bankruptcy. The bankruptcy which had taken place nine years before was of a company which had no connection

have held that the materiality of a bankruptcy derives from its potential to impact the financial condition or future prospect of ***the offering entity***. That is, there must be some connection between the prior bankruptcy and the investment being considered by the investor.[72] Here, Enforcement did not set forth any evidence that the Chapter 11 was either "related to the financial condition or prospects" of the particular offering, or that Brogdon "committed some wrongdoing" while at NHC.[73] Moreover, as in *Fischer* and *Feinberg,* the prior bankruptcy was extremely old at the time of the first offering at issue (11 years). Given its age and lack of connection to the offerings at issue, the Chapter 11 filing was not a material fact that needed to be disclosed.

Finally, assuming, *arguendo,* that the Chapter 11 was material, CRI and Anthony Cantone did not act negligently in omitting its disclosure from the COPs. In light of the facts set forth above and the questionable materiality of the bankruptcy, CRI and Mr. Cantone did not act unreasonably in failing to identify it as material, under the circumstances and at the time the due diligence on each offering was performed.

2. RCA Tax Liens

Unlike NHC, Brogdon's work at RCA was detailed in the CDMs. Accordingly, the statements about his experience in the CDMs – if false or misleading – were capable of creating a duty also to disclose balancing negative facts. Under the facts presented here, however, the

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with commodity trading. Moreover, Leighton provided plaintiff with a means through which he could easily have gained further information regarding the bankruptcy.")

[72] The Commission should consider the disclosure obligation FINRA's reasoning creates: merely mentioning that someone served as an officer of a company mandates the disclosure of any arguably negative fact about that entity in a subsequent and unrelated securities offering.

[73] *Fisher*, No 1996 WL 586345, at *10.

liens imposed on RCA were not balancing "negative" facts rising to the level of materiality. Indeed, there are absolutely no facts in the record about the liens, other than their amount.

Enforcement argued, and the NAC concluded, that the tax liens were evidence that Brogdon was not "business savvy," that his "ability to manage the business" was questionable, and that the recitation of his experience at RCA is misleading without mention of the liens because it casts Brogdon in a deceptively positive light.[74] Yet, the mere fact that Brogdon was the Chairman of a company that was subject to tax liens – 14 years before the offerings at issue, for an unestablished time period, and with an unknown resolution – is not *per se* a material fact.[75]

A primary defect of Enforcement's position with regard to the liens, and the NAC's acceptance of the same, is the lack of supporting evidence. FINRA has taken the position that a tax lien is inexorably negative, reflecting poorly not only on the institution against which it is imposed, but against the individuals behind that institution. Without Enforcement establishing the reason they were imposed, however, whether or not the imposition was justified, whether the liens were contested or not, whether they were ultimately paid, or whether they were pursued or withdrawn by the IRS, the NAC simply concluded that liens were negative facts *about Brogdon.* This allegation -- devoid of any supporting evidence in the record – is insufficient to establish materiality by a preponderance of the evidence. For this reason alone, the finding should be reversed.[76]

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[74] ROA014210.

[75] This is true under the authorities cited above regarding temporal remoteness, as well as the reasoning the Hearing Panel employed with regard to the other disclosures. ROA0013557-0013559.

[76] The NAC also based its materiality finding on the "fact" that the liens were "large." $4 million is a lot of money, to be sure and for most of us, would represent a sizable lien. Yet, RCA was a huge company, trading on the NYSE,

Beyond that, the NAC improperly concluded that the imposition of the liens shed some light on Brogdon's business acumen. Yet, the record is entirely devoid of any facts that would support the inference that the liens resulted from anything that Brogdon did or did not do as part of his leadership of the company.[77] The finding is unsupported by the evidence in the record and, as a result, should be reversed.

In the end, there is no support for the NAC's conclusion that the mere existence of old tax liens against an unrelated entity would be *substantially* likely to *significantly* alter a reasonable investor's decision to invest in the subject offerings approximately 11-15 years later. This case is not about an investment in RCA. It is about an investment decision in unrelated entities, and projects whose successes were simply incapable of being impacted by the liens imposed against RCA. In sum, the record is devoid of evidence to support the connection between RCA and the unrelated offerings – because no connection exists.

Finally, assuming, *arguendo,* that the liens were considered to be material, CRI and Mr. Cantone did not act negligently in omitting them from the COPs. For the reasons already expressed, given the passage of time and the lack of connection between Brogdon's tenure at RCA in the 1990s and the offerings at issue (2010-2013), CRI and Mr. Cantone did not act unreasonably in failing to identify these liens as material, under the circumstances and at the time the due diligence on each offering was performed.

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worth approximately $350,000,000. ROA006536. Thus, the liens represented approximately 1% of the company's value. Thus, the $4 million amount, alone, does not even establish that the liens were "large."

[77] As noted herein, there are no supporting facts regarding these liens, other than their amount.

3. The Georgia Summary Judgment Order

The NAC found it material that in 2003, Brogdon lost a summary judgment motion and was ordered by the court to repurchase stock.[78] The NAC reasoned that because the offerings at issue involved personal guarantees by Brogdon, then "there is little doubt that a reasonable investor deciding whether to purchase Brogdon COPs would consider the court's order that Brogdon refused to honor a similar personal guarantee to be an important fact."[79] This reasoning both over-simplifies the Georgia court action and overstates its relevance.

First, there is nothing in the record to support the conclusion that the stock repurchase agreement was "similar" to the personal guarantees at issue here. In the COPs underlying the Complaint here, Brogdon guaranteed investors' interest and principal payments.[80] The Georgia court action involved two simultaneously-executed contracts between Brogdon and an entity called ProFutures. The dispute there was over whether or not the two contracts should be viewed as one agreement, or two separate agreements.[81] The court sided with ProFutures and ordered Brogdon to comply with the first of the two agreements, which obligated him to repurchase certain outstanding shares in his company.

That is the entirety of information in the record regarding this lawsuit – the fact that the parties disagreed as to the terms of an agreement and ended up in court. There is *no* evidence that Brogdon failed to comply with the court's order on what the agreement required of him (i.e., evidence that would show a resistance to perform under a contract *where obligated to do so*). There is *no* evidence in the record that either of the two agreements at issue in that case is

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[78] ROA014212.

[79] *Id.*

[80] E.g. 006529 (Columbia). Near identical guarantees appear in each of the nursing home offerings.

[81] ROA001894-001895.

"similar to" the personal guarantee Brogdon made in connection with the COP offerings. There is *no* evidence in the record to suggest that Brogdon failed to do what the court ordered him to do, or that he was unable to afford to repurchase the shares.

The absence of this evidence is glaring considering the purported relevance of this 2003 dispute. The fact that the parties to these contracts ended up in litigation over their terms is not, as the NAC concluded, material. If Enforcement had offered evidence that Brogdon refused to comply with the court's directive, or that he was financially unable to meet that obligation, those facts could arguably be relevant to an investor weighing the value of a Brogdon guarantee (putting aside, for the moment, the impact the passage of time has on the Georgia order). Enforcement, however, did not adduce such evidence. As a result, it did not carry its burden of proving materiality.[82]

Moreover, even if the Commission determines that an obscure, unrelated, dated summary judgement ruling from Georgia was material, it should nevertheless conclude that CRI and Mr. Cantone's failure to find and disclose the order or identify its import was not negligent. Indeed, the sole basis for the Georgia order's supposed materiality, according to the NAC, appears to be the court's description in the order of one of the two agreements at issue there as "essentially a personal guarantee."[83] Therefore, the NAC concluded – without knowing any other information about the contract or the dispute at issue in the Georgia case – that it must be relevant information in an offering that included an actual guarantee.

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[82] The lack of evidence is underscored by the NAC's reasoning that "a reasonable investor would want to know" about the case because "the same scenario played out with the Brogdon COPs." ROA014213. This retrospect-driven analysis, of course, is inappropriate. The question is whether the Georgia order was material at the time the offer to purchase was made, not whether it is material in omniscient hindsight.

[83] ROA014212.

This reasoning – connecting the Georgia order and the COP offerings – is severely strained. CRI and Mr. Cantone, as they performed their due diligence review of Brogdon and his companies, would not only have had to find this order, they would have also had to accept the NAC's reading of it (i.e., concluding that the mere *fact* that the parties went to litigation creates an inference of suspicion around Brogdon) to reach the ultimate conclusion that an investor in a project guaranteed by Brogdon would be "substantially likely" to rethink investing in the project because he once lost a contract dispute on summary judgment. Certainly, the failure to reach this conclusion does not amount to negligence.

4. The NASD Bars were not Material

The final Brodgon-background events are the 1984 and 1985 bars by the NASD. The Hearing Panel found that the bars were not material because, at the time of the offerings, they were (1) more than 20 years old and, (2) after the bars were imposed, Brogdon had applied for, and received, permission from the Nasdaq to serve as the officer of a public company. The NAC then reversed this finding and determined the bars to be material, notwithstanding the passage of time because (1) the age of the bars is only one factor in determining materiality; (2) the bars are "significant" actions by FINRA, (3) the bars are still in effect; and (4) the approval of the Nasdaq is not persuasive.[84]

The NAC's findings are in error. *First*, the NASD bars occurred 25 and 26 years prior to the first offering at issue. By the last offering, they were 30 years old.[85] As CRI, Mr. Cantone,

[84] ROA014208.

[85] ROA013391.

and the Hearing Panel concluded, relevance of the NASD actions diminished as the decades passed.[86]

Second, even if age is not the only factor to consider in determining materiality, it still must be afforded its weighted value. Pursuant to the Hearing Panel's post hearing Order[87], the parties were ordered to include in their post hearing briefs legal authority on how the passage of time impacts the materiality of each background event. That authority reveals that even more recent, "significant" judgments than a 26-year-old FINRA bar can become immaterial with the passage of time.[88] This includes a 17-year old guilty plea and an 11 year-old criminal conviction.[89]

Third, the NAC improperly ignored the importance of the Nasdaq's subsequent approval of Brogdon, notwithstanding the bars.[90] The NAC found that the Nasdaq's considerations in approving Brogdon included factors that were "distinct" from the materiality standard. In making this finding, however, the NAC focused on a single factor – threat to investing public – the Nasdaq employed in making this determination. Yet, the remainder of the Nasdaq's analysis, which the NAC ignored, is strikingly similar to a materiality analysis, and includes a consideration of: [91]

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[86] ROA013714.

[87] ROA013439.

[88] ROA013555-13564.

[89] *Barron Partners, LP v. LAB123, Inc.*, 593 F. Supp. 2d 667, 673 (S.D.N.Y. 2009) (17-year-old criminal guilty plea immaterial due to passage of time); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990) (11-year-old criminal conviction not material).

[90] In 1994, Brogdon submitted an application to the Nasdaq to have RCA listed. Under Nasdaq Rules, RCA could not be listed because of the NASD bars. In order for the Nasdaq to allow the company to be listed on the exchange, Brogdon had to apply for a variance and establish that his regulatory history did not "rise [] to the level of a public interest concern." The Nasdaq – which was owned by the NASD at the time – approved the request, and allowed him to serve as Chairman and majority stockholder of a publicly listed company.

[91] Nasdaq Rule 5101.

- The nature and severity of the conduct, taken in conjunction with the length of time since the conduct occurred;
- Whether the conduct involved fraud or dishonesty;
- Whether the investing public was involved;
- How the individual had been employed since the violative conduct;
- Whether there are continuing sanctions;
- The totality of the individual's relationship to the Company, giving consideration to:
    - The individual's current or proposed position;
    - The individual's current or proposed scope of authority;
    - The extent to which the individual has responsibility for financial accounting or reporting; and
    - The individual's equity interest.

Thus, the Nasdaq's determination, while it does not *resolve* the issue of materiality specifically, supports CRI and Mr. Cantone's view, as well as the Hearing Panel's finding, that this substantive, intervening event by a securities industry regulator, in addition to the passage of time, "vitiates the materiality" of the 1984 and 1985 NASD actions.[92]

Fourth, even if the NAC was correct, however, that the two analyses were "distinct," the Nasdaq's approval nonetheless *impacts* the materiality analysis. This approval was, itself, an indication as to the importance of this event (in 1994). It signaled to RCA, to RCA's shareholders, and to the public that *notwithstanding* the findings made by the NASD in the 1980s, Brogdon nonetheless qualified to serve as the top officer for a publicly-traded healthcare company. Indeed, if the Nasdaq was willing to overlook the bars in 1994, it is reasonable to assume an investor would do the same, 15 years later.

Fifth, there is no connection between the NASD bars and the offerings at issue. Unlike the other negative events discussed in this Brief, the NASD bars do not relate to nursing home

[92] 013443 Enf. Br. p. 37.

developments or Mr. Brogdon's ability to manage them; nor do they turn on Brogdon's financial wherewithal, such that they are relevant to his ability to honor a personal guarantee. Further, even though they are "still in effect," as the NAC notes, they did not inhibit or prohibit Brogdon from operating outside of the broker-dealer service context, as evidenced by his subsequent, lengthy success in healthcare and the Nasdaq's refusal to allow the bars to impede Brogdon's ability to manage RCA.

Sixth, as discussed above, the duty of disclosure in this instance only arises if an "omitted fact was necessary to render a preexisting statement not misleading."[93] Here, there is no incorrect statement about Brogdon that the NASD bars are required to "cure," since Brogdon's experience running a broker-dealer in the 1980s was not mentioned – let alone relied upon – in the offering documents.

For each of these reasons, or all of them together, the NAC's finding that the 26-year-old NASD bars are material should be reversed.

Moreover, even if the fact that Brogdon had been barred by FINRA is of evergreen "significance" in FINRA's eyes,[94] the NAC erred in determining that CRI and Mr. Cantone acted negligently in failing to disclose them. To find that CRI and Mr. Cantone acted negligently, the Commission must conclude that they did not "exercise the standard of care that a reasonably

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[93] *Thompson v. RelationServe Media, Inc.*, 610 F.3d 628, 681 (11th Cir. 2010).

[94] The NAC's reliance on the "significance" of the bars is undermined by the Nasdaq's approval of the application. If the bars were as "egregious" and eternally meaningful, as the NAC suggests, sufficient to cast doubt on Brogdon's trustworthiness as CEO, the Nasdaq – which was then owned by the NASD – would not have approved the application.

prudent person would have exercised in a similar situation . . . [Negligence] connotes *culpable carelessness*."[95]

Here, for the reasons set forth above, there is no evidence that CRI and Mr. Cantone acted unreasonably or carelessly in not disclosing these events because the materiality of these dated events is, at best, questionable. It is clear that materiality is not evident, as these events do not present an "obvious danger of misleading investors."[96]

In light of the difficulty of determining the materiality of these events, CRI and Mr. Cantone did not act with "culpable carelessness" in not disclosing them. Accordingly, all negligence-based findings against them should be reversed. Indeed, the mere fact that there is a disagreement between the Hearing Panel (which concluded that the NASD bars were too old to have any lingering chance at materiality) and the NAC (concluding the opposite) is itself evidence that a reasonable individual could conclude the same.[97]

Moreover, the authority the Hearing Panel relied upon in finding the bars to be immaterial to the offerings states that just because a fact has some "marginal relevance" does not mean it is material.[98] Further, those authorities explain that "it is a matter of judgment" in determining the level of importance to be assigned to such an old event.[99] Accordingly, one could act "reasonably," yet reach the incorrect conclusion (at least according to the NAC) as to

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[95] ROA013737 (quoting *John P. Flannery*, Initial Decision Release No. 438, 2011 SEC LEXIS 3835 *104 (Oct. 28, 2011)).

[96] *City of Dearborn Heights v. Waters Corp.*, 632 F. 3d 751 (1st Cir. 2011); *Minneapolis Firefighters' Relief Ass'n v. MEMC Elec. Materials, Inc.*, 641 F.3d 1023, 1030 (8th Cir. 2011).

[97] ROA013715. The Hearing Panel held:

> [T]here is not a substantial likelihood that a reasonable investor, deciding whether to invest in the COPs, would find disclosure of the 1984 and 1985 NASD bars to significantly alter the total mix of available information. Therefore, failure to disclose them was not a material omission.

[98] *Barron Partners*, 593 F. Supp. 2d at 673.

[99] *Hollinger.*, 914 F.2d at 1564.

whether the 20+ year-old bars were material. In the absence of unreasonable conduct, however, the NAC's finding of negligence must be reversed.

Finally, the NAC found CRI and Mr. Cantone's conduct negligent because they "unquestionably" relied upon the information contained in their records regarding the immateriality of the bars, instead of conducting additional research. This finding conflicts with the evidence. CRI and Mr. Cantone did not simply rely upon this research.[100] They obtained a letter from Brogdon's counsel explaining the circumstances surrounding the events.[101] In addition, CRI's *own attorney* had opined that the bars were no longer relevant disclosures given the passage of time.[102] Indeed, years prior to the first private placement offering, and in connection with one of the Brogdon municipal offerings, Gardner advised that the disclosure regarding the NASD bars could be removed because he did not think it relevant.[103]

It was therefore reasonable, given the age of the bars and the lack of connection to the COPs at issue, for CRI and Mr. Cantone to concur with the advice of their counsel that the bars were no longer relevant.[104]

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[100] Relevant here, the unrebutted evidence reflected that CRI and Mr. Cantone's due diligence on Brogdon was cumulative and began not with the first COP offering, but in connection with several municipal bond deals that CRI was involved in years earlier. ROA001112; ROA001108 ROA000940-000941; ROA000948-000949.

[101] ROA006803.

[102] ROA013391; ROA001119; ROA001601; ROA001121;

[103] ROA 013391. Similarly, the record contains contemporaneous nursing home-related offerings involving Brogdon but *not* involving CRI or Attorney Gardner. Those COPs contain the same description of Brogdon, and omit the information Enforcement alleged material. ROA 010165. These documents further evidence the reasonableness of CRI and Mr. Cantone's conclusions at the time.

[104] *Streber v. C.I.R.*, 138 F.3d 216, 219–20 (5th Cir. 1998) ("In this case we find that the Tax Court clearly erred when it sustained the Commissioner's assessment of a negligence penalty, because appellants reasonably relied on the advice they received from their attorney, Edwin Hunter. Due care does not require young, unsophisticated individuals to independently examine their tax liabilities after taking the reasonably prudent step of securing advice from a tax attorney.").

Accordingly, for each of the above reasons, or all of them taken together, the Commission should reverse the NAC's finding that Applicants negligently failed to disclose the NHC bankruptcy, the Georgia summary judgment order, the RCA liens, and the NASD bars.[105]

C. Events Concerning Brogdon Are Not Material to the Cherokee Offering

Unlike the nursing home developments,[106] Brogdon was not responsible for developing, operating, or selling the Cherokee real estate development. Instead, Cherokee was in the hands of an experienced real estate developer,[107] Bruce Alexander, who had developed several similar communities in the past. (Mr. Cantone even visited Alexander's other developments, as part of the Firm's due diligence, to see for himself what the communities looked like when done). Also unlike the nursing home developments, the Cherokee offering was not personally guaranteed by Brogdon. Accordingly, information regarding Brogdon's financial condition and obligations were irrelevant (and immaterial) to the Cherokee offering, given that investors were not relying upon Brogdon's financials either to complete the project or, if the project failed, to enforce the guarantee. Because Brogdon's role in Cherokee was reduced merely to owning an interest in LLC that owned the underlying real estate, the importance of any particular information about Brogdon was similarly diminished.

The NAC Decision did not consider (or base its ruling on) Brogdon's role in the Cherokee offering; nor did it identify a statement in the Cherokee CDM giving rise to disclosure

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[105] ROA014220.

[106] In each nursing home development, Brogdon was responsible for bringing the investment to fruition, whether by developing the facility, rehabilitating the facility, improving operations, or selling (ideally) for a profit.

[107] ROA006758-6759.

obligation.[108] The NAC's decision on this issue is erroneous and internally inconsistent. Throughout its Decision, when considering the four nursing home offerings, the NAC determined that specific facts were not only relevant, but *material* to potential investors because they provided information that could be used to assess (1) Brogdon's ability to honor his guarantee or (2) his relevant expertise or qualifications.[109] In reviewing the materiality of this same information, however, with regard to Cherokee, the NAC reversed course and concluded that even though Brogdon was not responsible for completion of that project, and despite the fact that he was not the guarantor, the information was still material because he was "sufficiently central"[110] to the offering and therefore his "financial problems and lack of personal and business integrity would just as significantly influence the purchasers of the COPs as would a personal guarantee."[111]

There is simply no evidence to support this conclusion. As noted above, the Cherokee offering sought to raise funds to develop and sell a residential real estate community in Conyers, Georgia.[112] One of Brogdon's LLCs, Arcadia Partners, owned the underlying real estate (38 acres) and had divided and zoned the land to allow for the contemplated construction.[113] Initially, Brogdon owned all of Arcadia Partners but, as part of the offering, the developer of the planned

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[108] Indeed, the NAC made the unsupported finding that the Cherokee offering "resembled the previous Brogdon-related COPs" except for the five year maturity period (instead of the two year repayment period found in the nursing home deals). As stated herein, Cherokee had very little resemblance to the nursing home deals.

[109] Ex. ROA014210 (relevance of RCA tax liens); ROA014211 (relevance of NHC bankruptcy); ROA014212 (relevance of Georgia summary judgment order); ROA014215 fn. 9 (regarding source of payments); ROA014207 (relevance of NASD bars); ROA014213-014214 (late/missed payments).

[110] The Commission will note that the language that the NAC relies upon in support of its conclusion that Brogdon is "emphasized" as a "central participant" appears at the end of the CDM under the heading "certain relationships." The section discloses Brogdon's role in the *transactions* described in the CDM (not the development) in light of his ownership in some of the underlying LLCs.

[111] ROA014217.

[112] ROA006749 et seq.

[113] ROA006755.

community, Bruce Alexander, would take a 30% interest in the entity. Cherokee Financial LLC, the entity issuing the COP, would take 35%.[114] While Brogdon managed Arcadia, Bruce Alexander and his company, Lifestyle Homes of Distinction, was responsible for construction of the project.[115] The CDM contains a detailed description of Alexander's biography, experience, and successful past developments.[116] That narrative is followed by a detailed description of the real estate, planned project, time table, and other construction specifics, providing potential investors with information on both the current and potential value of and demand for the completed community.[117] None of this relates to Brogdon.

Instead, Brogdon's role in Cherokee was little more than his LLC's ownership interest in the underlying real estate. None of the facts about either his background or his performance in the nursing home industry have any impact on the Cherokee development.[118] Thus, these facts, although perhaps interesting in hindsight, were not material to an investor, in May 2013, deciding whether to invest in the real estate project.

Nor does the Chelsea Guarantee change the analysis. The NAC concluded that there was no practical difference between Brogdon personally guaranteeing the notes and Brogdon owning an entity that issued a personal guarantee (confined to the assets of the entity).[119] This is clearly

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[114] Leaving Brogdon with a 35% stake.

[115] ROA006756.

[116] ROA006756-006757.

[117] ROA006757-59.

[118] *Wu v. Stomber*, 883 F. Supp. 2d 233, 259 (D.D.C. 2012), *aff'd*, 750 F.3d 944 (D.C. Cir. 2014), *aff'd*, 750 F.3d 944 (D.C. Cir. 2014); *In re TVIX Sec. Litig.*, 25 F. Supp. 3d 444, 453 (S.D.N.Y. 2014), *aff'd sub nom. Elite Aviation LLC v. Credit Suisse AG*, 588 Fed. Appx. 37 (2d Cir. 2014) ("To the extent that Plaintiffs' contra-indicator approach relies on reading individual words and phrases against each other in isolation, its consistency with these principles is questionable... Plaintiffs have not pleaded plausibly that a reasonable investor could have read the Offering Documents [to imply the things suggested]").

[119] ROA014217.

erroneous. Chelsea is a distinct legal entity from Brogdon with different assets. Further, facts material to determining the value of a Chelsea guarantee are those relating to its assets and financial strength. Facts relating to the manager of Chelsea (or his personal finances) are simply not relevant – let alone material – as they add nothing to the assessment of Chelsea.

The NAC determined that since Brogdon controlled Chelsea (the guarantor), information relating to Brogdon and his "integrity" is automatically material to the offering.[120] This conclusion, however, ignores both the definition of materiality and the evidence presented. As set forth above, none of the Brogdon-related facts have any bearing on the Cherokee development; nor are they relevant to assessing the guarantee. Accordingly, there is insufficient evidence to conclude that these facts are "material."

Further, and with specific regard to the value of the Chelsea guarantee, the most important (and negative) facts that investors would find material in assessing that guarantee are expressly set forth in the Cherokee CDM.[121] The CDM stated (all font in original):[122]

> **Value of the Chelsea Guaranty Agreement.** Although Arcadia Partners' payment and other obligations under the Cherokee Note will be guaranteed by Chelsea (see "THE CHEROKEE NOTE CERTIFICATES OF PARTICIPATION -- Sources of Payment for the Cherokee Note Certificates of Participation" herein), there can be no assurance that, if called upon, Chelsea would have the liquid assets necessary to meet all of its obligations under the Chelsea Guaranty Agreement in a timely manner, or at all... **POTENTIAL INVESTORS SHOULD MAKE THEIR INVESTMENT DECISION BASED UPON THEIR EVALUATION OF THE DEVELOPMENT PROJECT, AND NOT IN RELIANCE UPON THE CHELSEA GUARANTY AGREEMENT.**
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> ***

[120] *Id.*

[121] ROA006765 (emphasis in original).

[122] ROA006765 – ROA006766.

(b) Payments made by Chelsea Investments, L.L.C. ("Chelsea"), which is an affiliate of Arcadia Partners, pursuant to a Guaranty Agreement in favor of the Note Purchaser (the "Chelsea Guaranty Agreement"). **There can be no assurance that Chelsea will have the resources needed for it to make any such payments. See "CERTAIN RISKS OF INVESTMENT" herein.** The Note Purchaser will hold the Chelsea Guaranty Agreement in trust for the equal and ratable benefit of the purchasers of the Cherokee Note Certificates of Participation.

The above language informs potential investors that the Chelsea guarantee is highly questionable and that they should not base their decision to invest on its promise to pay. This is an unequivocally negative disclosure to investors, meant to ensure that they properly understood that the guarantee was of questionable – if any – value and that they should make an investment decision on the project itself. This disclosure *de*-emphasizes the value of Chelsea and, contrary to the NAC's findings, Chelsea's management.

In light of these facts, the information relating to Brogdon and his prior experience in the nursing home business is not material to the Cherokee offering. The NAC's finding to the contrary should be reversed.

D. If the Brogdon Facts are found to be Material to Cherokee as a result of the Chelsea guarantee, they were not omitted negligently or with scienter[123]

1. CRI and Mr. Cantone did not act with scienter because they relied upon the advice of their counsel as to the materiality of the Brogdon Guarantee.

In the event that the financial events, including the late payments, extensions, and issues relating to the nursing home projects are found to be material facts, requiring disclosure in connection with the Cherokee offering due to the existence of the Chelsea guarantee, their omission was not made with scienter.

[123] The evidence reflecting Applicants' reasonable reliance on the advice of their counsel, and the import of that evidence, is discussed in Sections C.2. (above) and E and H (below).

The Cherokee CDMs were drafted by CRI's attorney, Mr. Gardner.[124] At the time of the CDM, Gardner was aware of the payment issues and extension agreements, and its potential import to Cherokee investors.[125] Moreover, the evidence shows that Mr. Gardner considered the materiality of those facts and found that the obligation to disclose them arose out of a personal guarantee by Brogdon. Indeed, the evidence is that the determination to have Chelsea, instead of the Brogdons, guarantee the Cherokee offering was a decision that was made in consultation with counsel.[126] This legal advice was reduced to writing.[127] In preparing the Cherokee CDM, Applicant's counsel, Michael Gardner, sent Mr. Cantone an email explaining to him that if the Brogdons guaranteed the Cherokee offering (as they had done in the past), then the payment issues in the other offerings would need to be disclosed in the Cherokee offering documents:[128]

From: GARDNER4LAW@aol.com
Sent: Wednesday, April 10, 2013 12:18 PM
To: ajcantone@cantone.com
Subject: Arcadia

Anthony:

1. Do you wish me to draft all of the documents (other than the Cherokee Operating Agreement) that I have heretofore done in these transactions?

2. Do you realize that, if you have a Chris and Connie guaranty agreement, you will need to disclose detail about their multiple failures to perform under previous guaranties?

Please advise. . . . .MRG

[124] ROA010267-010268; ROA001187.

[125] ROA006297-006298Both Columbia extension agreements reference the facilities inability to make its payment obligations. (ROA 002805 and 002829)..

[126] ROA001069; ROA006297-006298; ROA009865-009866, ROA009867-009892, ROA009893-009898; ROA001264. The advice of counsel defense requires Respondents to establish four elements: (1) complete disclosure to counsel; (2) request for counsel's advice as to the legality of a contemplated action; (3) receipt of advice that the contemplated action is legal; and (4) good faith reliance on that advice. S.E.C. v. Prince, 942 F. Supp. 2d 108, 138, 143-44 (D.D.C. 2013).

[127] *Id.*

[128] ROA006297-006298.

The Brogdons of course, did not extend the guarantee. Thus, when Gardner prepared the Cherokee offering documents without that provision, he determined that the payment issues with the other offerings did not need to be disclosed to investors in the Cherokee offering. [129] It bears repeating, he omitted these disclosures with awareness of (a) the Brogdons' missed payments[130] and (b) the fact that Brogdon owned Chelsea.

In turn, because the Cherokee offering did not carry a personal guarantee from "Chris and Connie," Brogdon's finances and "integrity" were not material disclosures.[131] The unrebutted testimony of Mr. Cantone is that Attorney Gardner concluded that the prior payment issues were not material because there was no personal guarantee from Brogdon, and that he (Mr. Cantone) relied upon his counsel's legal conclusion.[132]

Attorney Gardner's analysis applied the same standard considered here: materiality. In offerings personally guaranteed by Brogdon, facts surrounding the strength of his financial wherewithal may have significantly altered the total mix of information presented to an investor assessing the strength of the guarantee, and thus the decision whether to invest in a Brogdon-guaranteed offering. But, in the case of the Cherokee offering, which was not personally guaranteed by Brogdon, and whose offering documents advised and warned that: (1) the Cherokee offering is guaranteed by Chelsea, and (2) investors should place no import on that guarantee, and make "their investment decision based upon their evaluation of the development

[129] In drafting the Cherokee CDM, Gardner was well aware that Chelsea was the guarantor and that Brogdon owned Chelsea. Yet, he did not advise the Cantones that the disclosures about Brogdon's "multiple failures to perform under previous guarantees" had to be disclosed in that circumstance. The Cantones relied upon his expertise on this issue.

[130] ROA 0006297-98.

[131] ROA006297-006298; ROA009865-009866, ROA009867-009892, ROA009893-009898; ROA001263-001264.

[132] ROA001263-001265.

project, and not in reliance upon the Chelsea Guaranty agreement" because "[t]here can be no assurance that Chelsea will have the resources needed for it to make any such payments," one cannot reasonably conclude that the Chelsea guarantee or Brogdon's financial condition is a material fact in the Cherokee offering. In other words, in the face of this language, there is not a *substantial likelihood* that information unrelated to the guarantor could have *significantly altered* the *total mix* of information presented to investors in Cherokee. Not surprisingly, CRI's counsel concluded that payment issues in other unrelated offerings need not be included in the Cherokee CDM.[133]

For the foregoing reasons, Brogdon's payment and other issues in the nursing home/assisted living facilities offerings are irrelevant to the Cherokee offering, and Applicants reasonably relied upon the advice of counsel who reached that same logical conclusion.[134]

E. If the Brogdon Facts are found to be Material, they were not negligently omitted.[135]

For the same reasons set forth above, the evidence in this case does not support a finding of negligence, given CRI and the Cantones' good faith conduct, considerable due diligence, personal investments in the offerings, and their good faith retention of, and reliance upon, experienced counsel.[136] To find that they acted negligently, the evidence must prove that they did not "exercise the standard of care that a reasonably prudent person would have exercised in a similar situation." [137] "[Negligence] connotes *culpable carelessness*."[138] While reliance on

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[133] ROA006297-006298; ROA009865-009866, ROA009867-009892, ROA009893-009898; ROA001264, and ROA006749-006774.

[134] Applicants' reasonable reliance upon the advice of counsel is addressed Sections C.2. and E., below.

[135] If CRI and Mr. Cantone did not act negligently, they could not have acted willfully – defined as conduct that is more than negligent but less than reckless - and that funding must be reversed as well. ROA14205.

[136] *Streber v. C.I.R.*, 138 F.3d 216, 219–20 (5th Cir. 1998).

[137] ROA013737 (quoting *John P. Flannery*, Initial Decision Release No. 438, 2011 SEC LEXIS 3835 *104 (Oct. 28, 2011)).

counsel is not an affirmative defense that negates a finding of negligence (as it is for scienter), that reliance is nevertheless still relevant evidence to consider in determining whether an individual acted reasonably.

Here, a lay person, who is not entirely familiar with, let alone an expert on, the precise disclosure requirements – most of which included determining the parameters of materiality – acts reasonably by obtaining and relying upon the advice of experienced counsel. In fact, it would be unreasonable to presume that a lay person would take it upon himself to "independently examine" the applicable laws "after taking the reasonably prudent step of securing advice" from experienced legal counsel.

The NAC erred in concluding that Applicants acted with scienter or negligence in omitting the Brogdon-related facts in connection with the Cherokee offering. The finding should be reversed and any sanctions based thereon dismissed.

F. No Material Misrepresentations in connection with the Extension Agreements in Columbia and Oklahoma

The NAC erroneously concluded that the extension agreements executed by the LLCs for the Columbia and Oklahoma offerings constitute sales of securities, and that CRI had an obligation to disclose to investors that Brogdon had missed or made late interest payments in the offerings. Contrary to the NAC's finding, the extensions do not constitute sales of securities sufficient to satisfy the "in connection with" requirement of Section 17(a) of the Securities Act of 1933 ("Securities Act") or Rule 10b-5 of the Securities Exchange Act of 1934 ("Exchange Act"). Beyond that, the record does not support the finding that (1) the missed and late payments were undisclosed and (2) that those missed payments are material.

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[138] *Id.*

1. Extensions of the Deadlines Do Not Constitute Sales of Securities

Both Section 17(a) and Rule 10b-5 require that an omission or untrue statement of material fact occur "in connection with the purchase or sale of a security."[139] By definition, those causes of action do not extend to post-sale conduct.[140] The NAC, like the hearing panel, determined that the extension agreements were sufficiently "in connection with" the purchase or sale of a security based on *U.S. v. Durham.*[141] Durham, however, is easily distinguishable from this case. *First, Durham* was a criminal case, and the issue before the court was the propriety of a jury instruction. This proceeding is not a criminal case, and jury instructions are not at issue.

Second, in *Durham,* the defendants simply lied to the investors about the reason why the payments were delayed, and told them they were caused by "computer and banking issues."[142] There were no computer issues, however; in fact, the defendants in *Durham* were perpetrating a massive Ponzi scheme, and knew full well that the investments they held were worthless. Nevertheless, the defendants' misrepresentations were considered "in connection with" the purchase or sale because, in effect, they were a continuing cover-up of the misrepresentations made at the time of the initial offering (*i.e.*, the defendants' ongoing efforts to conceal the Ponzi

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[139] 17 C.F.R. § 240.10b-5(b); *U.S. v. Harris*, 919 F. Supp. 2d 702, 709 (E.D. Va. 2013); 15 U.S.C. §77q.

[140] *Harris*, 919 F. Supp. at 709; ("[15 U.S.C. Section 77q] is still limited to actions taken in the offer or sale of a security and does not include post-sale conduct . . . [a]ccordingly, where fraud in the sale of a security is alleged, the fraud must facilitate the sale of that security. Under this logic, any acts occurring post-sale would fall outside the scope of [the Section].") (emphasis added); Bosio v. Norbay Sec., Inc., 599 F. Supp. 1563, 1566 (E.D.N.Y. 1985) (considering § 10(b)) ("This principle has been reiterated in numerous district and circuit court cases in this circuit. The fraud practiced must have been prior to or contemporaneous with the sale of securities.") (internal citations omitted, emphasis added); Kogan v. Nat'l Bank of N. Am., 402 F. Supp. 359, 361 (E.D.N.Y. 1975) (same); Freschi v. Grand Coal Venture, 551 F. Supp. 1220, 1227 (S.D.N.Y. 1982) ("Therefore, there can be no causal connection where the alleged misrepresentation or omission occurred after the purchase.").

[141] *U.S. v. Durham*, 766 F.3d 672, 682 (7th Cir. 2014).

[142] *Id.*

scheme). Therefore, the reasoning the Court in *Durham* employed to find that the post-sale misrepresentations were made "in connection with" the original sales does not work here.

The continued reliance on *Durham* is inappropriate given the existence of authority that more properly aligns with the facts of this case. For example, in *BHC Interim Funding, L.P. v. Finantra Capital, Inc.*, the Southern District of New York found that an extension agreement did *not* fulfil the "in connection with" requirement of the Securities Act.[143] Specifically, the Court held:

> BHC also alleges that, after the loan transaction closed, there were additional misrepresentations, which misled BHC into excusing the October 2000 default and signing the Extension Agreement. But these alleged misrepresentations, made after the October 1999 closing, were not made "in connection with" the purchase or sale of any security.

A similar decision was reached in *Gaudin v. KDI Corp.*, where the court concluded that a guarantee extension did not constitute a purchase or sale of securities: [144]

> The undisputed facts of this case do not show any purchase or sale of any security in connection with the transaction in question. The plaintiffs complain that they were induced into signing the April 8, 1970, agreement by fraudulent statements made by defendants herein; and that pursuant to such agreement they did not sell the stock as to which the first part of the original warranty had expired. For the purposes of this jurisdictional inquiry, all that the defendants did was to extend a warranty, and all that the plaintiffs did was agree not to sell their stock. There was no purchase, and no sale . . . . To the extent that the agreement is anything other than a guarantee extension, it is a promise not sell [sic]. There is no aspect of the transaction in question that qualifies the plaintiffs herein as purchasers or sellers of securities.

Here, as in *Gaudin,* all that the LLCs for Columbia and Oklahoma did was agree to extend the maturity date on the notes and all investors did was to "not sell."[145] Here, as in

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[143] *BHC Interim Funding, L.P. v. Finantra Capital, Inc.* 283 F. Supp. 2d 968, 978 (S.D.N.Y. 2003).

[144] *Gaudin v. KDI Corp,* 417 F. Supp. 620, 627 (S.D. Ohio 1976), *aff'd sub nom. Gaudin v. KDI Corp.*, 576 F.2d 708 (6th Cir. 1978).

[145] *Id.*

Gaudin, the Commission should conclude that the agreements at issue are nothing "other than a guarantee extension" and a "promise not to sell." Thus, there is no aspect of the extensions that "qualifies the [individuals] as purchasers or sellers of securities.

2. The Extension of the Maturity Deadlines Were Not (and Could Not Be) Concealed

Similarly, with regard to the extension agreements, each COP, including Columbia and Oklahoma, had a specified maturity date upon which the principal and any outstanding interest would be repaid.[146] When that deadline came and went, the evidence shows that investors who had expected to receive their repayment were either explicitly informed of the fact that their interest payments were late, or were able to divine that fact for themselves when their principal payment did not arrive and, instead, interest payments continued.[147] Either way, because the fact of the extension was not (and could not be) concealed from investors, this fact was not a material "omission."

In light of this evidence, even if the Commission finds that the extensions of the maturity deadlines in Columbia and Oklahoma constitute sales of securities (which it should not do), the late or missed payments in those offerings were disclosed to, or otherwise known by, investors.[148]

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[146] *Id.* ROA06531 (Columbia); ROA006639 (Oklahoma).

[147] Many of the emails refer to calls received from investors asking why their payment was late. *See* ROA003509-003512; ROA003553-003554; ROA000974.

[148] As noted above, it is unclear from the Decision precisely which supposedly undisclosed late and missed payments should have been disclosed in each of the two offerings. Applicants assume that it is the late or missed payments in the specific offering (*e.g.*, late payments in Columbia should have been disclosed to investors in Columbia), as late or missed payments in other, unrelated offerings, whose success in not dependent upon the subject offering, are irrelevant.

3. The Interest Payments Were Not Required Disclosures at the Time of the Extension Agreements

The NAC concluded, in a footnote, that at the time that CRI entered into the extension agreements for Columbia and Oklahoma, respectively, it was required to disclose to each set of existing COP holders that Brogdon had missed certain interest payments.[149] For the reasons set forth in Section I.C., below, that conclusion is factually erroneous given the evidence in the record that CRI did, in fact, make this disclosure.

Beyond that, the NAC imposed this disclosure obligation on CRI, arguing that investors would find that information a "significant factor in determining whether or not to consent to a proposed extension agreement."[150] Investors, however, did not "consent" to the extension agreements. Instead, the agreements were entered into by the issuing entity (Columbia or Oklahoma) and Brogdon (or his respective entity); investors were later informed of the *fact* of the extensions.[151]

4. No Scienter.

Moreover, even if these omissions were material, the extension agreements were prepared by attorney Gardner[152] who was aware at the time he drafted each Columbia extension (October 2012 and January 2013) that the Columbia project was having issues making its payment deadlines.[153] Similarly, when Gardner drafted the Oklahoma extension agreement in

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[149]ROA014215-014216 fn. 19.

[150] *Id.*

[151] Indeed, the cases cited by the NAC in support of this finding all involve situations where a "reasonable investor" was deciding whether or not to make an investment purchase; none of the cited authority deals with the extension of the maturity date on an existing offering.

[152] ROA00966.

[153] Both Columbia extension agreements reference the facilities inability to make its payment obligations. (ROA 002805 and 002829).

July 2013, he was aware of the same. Indeed, he had recently sent CRI an email, in April 2013, telling CRI that Brogdon's payment issues would be required disclosures if he guaranteed another offering.[154] Yet, Attorney Gardner, in preparing these documents, sent no similar email indicating that CRI had an obligation to disclose the extension agreements themselves or the fact that they were necessitated by payment issues (although this is the obvious point of extending maturity). The fact that CRI and the Cantones retained counsel to assist them with the extensions and that they were not advised the agreements were disclosable, reflects the reasonableness of their conduct and their good faith intentions, mitigating the need for sanctions.[155]

G. Investors were informed of the Source of Interest Payments

The NAC erred, as a factual matter, in determining that CRI and Mr. Cantone concealed from investors the material facts surrounding the extension agreements. The NAC found that the CRI and Mr. Cantone had acted with scienter in entering into the extension agreements without disclosing (1) that the LLCs (opposed to Brogdon) had made some of the recent interest payments when Brogdon failed to do so; and (2) that the maturity dates were being extended.

With regard to the interest payments on Columbia and Oklahoma, the evidence established that investors were either explicitly informed of the fact that their interest payments were late, or were capable of understanding that fact when their scheduled payment did not arrive timely.[156] Mr. Cantone regularly called his investors to advise them of late interest

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[154] ROA006297-006298.

[155] Sanction Guidelines, Principal Consideration 7.

[156] Many of the emails refer to calls received from investors asking why their payment was late. *See* ROA003509-003512; ROA003553-003554; ROA000974.

payments, and to let them know when the payment would be received.[157] Investors called to testify confirmed this fact.[158] The NAC improperly disregarded both Mr. Cantone's testimony and that of his clients largely because "there [was] no documentary evidence" to corroborate it. This summary rejection of the testimony presented about communications – including customer testimony – was improper.[159]

H. Mrs. Cantone and CRI Reasonably Supervised the Sales of the Offerings

The sole finding against Mrs. Cantone is that she and CRI allegedly failed to reasonably supervise Mr. Cantone in connection with his sales of the subject offerings, specifically, by allowing the Columbia and Oklahoma extension agreements to be executed without disclosing the late interest payments.[160] Ignoring the entirety of the evidence on Ms. Cantone's role at the Firm and how she supervised both Mr. Cantone and the offerings at issue,[161] the NAC focused solely on the fact that she was aware of the missed interest payments and the extension agreements. For the same reasons set forth above in Section I.C., because there is no material

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[157] ROA000968; ROA001070; ROA001091.

[158] ROA001589; ROA010443-010444 ("[Anthony] told me if an interest payment was late and that he would be covering the payment so that the interest would be received as planned."); RX-350 ("Anthony and I spoke regularly about the payments and I was aware that Mr. Brogdon's payments were delayed...I knew that Anthony had paid my interest to me, so I would have it as planned. I was not misled or lied to about these payments."); ROA010461-010462 ("I believe Anthony stepped in and protected investors who depended on receiving the income.").

[159] ROA014216. The NAC also points to "inconsistent" testimony by Mr. Cantone. However, the record is not nearly as clear as suggested, when it comes to Mr. Cantone's testimony. The lines of testimony that the NAC puts together to form one responses are from two different lines of questioning with 400 pages of testimony between them. ROA 00857 (quoting from page 337 of the OTR transcript); ROA 000858 (page 792 of the OTR transcript). Further, the first set of answers is about the *Cherokee* offering, not communications directly with Columbia or Oklahoma investors.

[160] ROA013744-013745.

[161] ROA001599 (1886:3–1887:10:25) (1885:14-1886:2); ROA001200 (1889:4-14); ROA011545, ROA011552, ROA011554, ROA011590, ROA011637, ROA011676, ROA011762, ROA011839, ROA011839, ROA011844, ROA011878, ROA011884, ROA011902, ROA011956, ROA011958, ROA012011; ROA012510, ROA012516, ROA012635, ROA012682, ROA012705, ROA012731, ROA012740, ROA012744-012746, ROA012748, ROA012839-012841; ROA012843, ROA012874, ROA012907, ROA012939, ROA012978, ROA013011, ROA012996, ROA013006, ROA013008, ROA013058.

misrepresentation in connection with the purchase or sale of a security, with regard to the extension agreements, the charges against Ms. Cantone for failing to supervise the same should be reversed. Additionally, for the reasons set forth in Section I.D, above, because any omissions that did exist were not made with scienter or made negligently, the charges against Ms. Cantone for failure to supervise should be reversed.

Perhaps more troubling is the NAC's characterization of Ms. Cantone as a recidivist because of the prior supervisory violation on her record (deriving from an Offer of Settlement). The NAC, who did not have the benefit of hearing her testify and explain the circumstances surrounding that disclosure, placed an even greater weight on this disclosure than the Hearing Panel and determined that its mere existence was cause for aggravated sanctions and harshly characterized Ms. Cantone as a dangerous "recidivist." Because the NAC members did not have the opportunity to listen to Ms. Cantone's testimony, the description of how she did her job, and how she supervised the COP offerings, it did not have the opportunity to witness her explanation of the prior charge that occupied so much of its focus. As to that event, Ms. Cantone testified:[162]

> There was a broker at our firm who joined in around early 2005. This man named Max Smith had come to us from very reputable firms. He worked at Rickels, Atlantic Group, Hillard, PNC. He had a good history of working with good-sized firms, reputable firms and he had no marks on his U4, so I had no reason to believe there was anything wrong with him.
>
> He had a record of being a pretty decent-sized producers at his previous firms. But when he came to us he was elderly and it was our impression he was winding down towards retirement and eventually we would handle his clients through some other people.
>
> What we did not know was that since 1992, he was -- he ran a scam and he stole money from his clients. And he did that conversion of client funds to his own personal use through his Merrill Lynch account.

[162] ROA001598.

So he ran a Ponzi scheme and we uncovered the scheme. And we fired him. And that led to whatever investigation took place. And I made an offer of settlement to put that behind me.

Q. When he -- when he was with his prior firms, Rickel, Hillard and PNC, was he doing -- conducting the same scheme when he was at those firms?

A. Yes.

Q. You were the one who caught him?...Cantone Research?

A. Yes.

Q. As far as you know, did any of those other firms enter into some sort of settlement or were they subject to any proceeding by FINRA in connection with this scheme?

A. Do you mean the firms where Mr. Smith was employed?

Q. Yes, I do.

A. Those were not.

Neither the facts of this case nor those of the prior case that appears on Ms. Cantone's record justify the NAC's imposition of sanctions – let alone justify increasing the Hearing Panel's suspension four times over. The NAC's findings should be reversed and the sanctions dismissed.

I. Sanctions[163]

For the reasons set forth above, the findings of liability against Applicants should be reversed, and, consequently, no sanctions should be imposed against them.[164] However, if the Commission were to affirm some finding of liability, it should significantly reduce the sanctions

[163] In this Brief, Applicants addressed the sanction factors set forth in the Decision. Additional factors and considerations related to sanctions are detailed in Applicants' Post-Hearing Brief, and those factors and considerations are incorporated herein by reference.

[164] The Sanctions imposed upon Ms. Cantone are discussed immediately above.

imposed, and impose the minimum sanctions for such violations set forth in the FINRA Sanction Guidelines ("Guidelines").

1. Sanctions Imposed for Negligence Claims

The NAC affirmed the Hearing Panel's finding that the negligence-based claims justified a one-year suspension for Anthony Cantone and a $100,000 fine.[165] For the reasons already set forth, articulating the highly questionable materiality of these facts and Applicants' reliance on their counsel to assist them in preparing the offering documents with the requisite background disclosures, the negligence-based sanction goes beyond "remedial" action and is solely punitive in nature.[166] Indeed, FINRA's own Sanction Guidelines state that in the case of negligent misrepresentations or omissions, the suspension range begins at just 31 days. Moreover, the negligence-based findings should properly be batched, under the Guidelines, given that Applicants are alleged to have made the exact same omissions in each successive Brogdon offering, the conduct was negligent, the conduct did not result in any investor injury, and the violations resulted from a single systematic problem that has been corrected.[167] Accordingly, any sanction imposed on the negligence-based claims is more properly assessed as a single omission and, in turn, the sanctions should be reduced.

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[165] The fine was jointly imposed on CRI.

[166] *FINRA Sanction Guidelines*; General Principal 1. ("Adjudicators should consider a firm's size with a view toward ensuring that the sanctions imposed are remedial and designed to deter future misconduct, but are not punitive. Factors to consider in connection with assessing a firm's size are: the financial resources of the firm; the nature of the firm's business; the number of individuals associated with the firm; and the level of trading activity at the firm.")

[167] *FINRA Sanction Guidelines*, p. 4: .Batching has found to be appropriate if: (1) the violative conduct was unintentional or negligent; (2) the conduct did not result in injury to public investors; or (3) the violations resulted from a single systemic problem or cause that has been corrected.

2. Sanctions imposed on Recklessness claims.

The NAC also imposed separate sanctions deriving from the allegedly intentional or reckless omissions.[168] Putting aside, *arguendo*, the merits of those allegations, the NAC itself recognized that the "intentional material misrepresentations and omissions" were limited to the extension agreements and the Cherokee offering. Yet, in imposing its sanction, the NAC referred to these "omissions" as involving "numerous acts, constituting a pattern, and occurred over a significant period of time."[169] The record, on the other hand, shows that these are only a few events, spread out in time, and not involving recurrent behavior. The extension agreement in Columbia (which was a profitable investment in the end) was executed in October 2012. The Cherokee offering was in May 2013. The extension agreement in Oklahoma was executed in July 2013. Even if these are considered material omissions, they are not part of a pattern or series of events, but rather the product of a single determination on a highly complex issue of materiality. In such cases, aggregation or "batching" of violations is appropriate when assessing sanctions. Here, each of these factors contained in the Sanction Guidelines mitigates in favor of batching, and therefore in a reduction of the sanctions imposed.

Further, as discussed above, relevant legal authority supports CRI and the Cantones' conclusion that the extension agreements were *not* offerings of securities (triggering the alleged disclosure obligation). This authority bolsters the determination that CRI made at the time and, in any event, weighs against imposition of a sanction.

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[168] ROA014225.

[169] ROA014226.

Moreover, as discussed above,[170] both the extension agreements and the Cherokee CDM were all prepared by attorney Gardner. As discussed herein, CRI and Mr. Cantone relied upon Gardner's advice and counsel in determining what facts (all known to Gardner) about Brogdon were material and how they should be disclosed. This reliance on their counsel not only rebuts the allegation of recklessness, it also weighs against imposition of a sanction.

3. The NAC improperly overruled the Determination that Cantone acted in good faith in attempt to protect investors.

The record established that CRI and Mr. Cantone acted in good faith, and in the best interest of the investors by: (a) offering to buy an investor's COP interest, at cost, if the investor did not like the new maturity date, even though he had no contractual obligation to do so;[171] (b) personally covering late interest payments for the offerings out of their own pockets, even though they had no contractual obligation to do so;[172] (c) retaining an attorney and obtaining judgments against Brogdon to enforce the guarantees; [173] and (d) the extended investment in Columbia was paid as hoped (albeit late) and turned out to be a profitable investment for the COP holders.[174]

The NAC overruled the Hearing Panel's determination that Applicants acted in good faith and with a desire to protect investors by keeping the projects viable, determining instead that this motivation was "neither aggravating or mitigating." [175] This ruling was in error. Not only does it ignore the evidentiary record and the credibility determinations drawn by the Hearing Panel, it

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[170] Section E.

[171] ROA001218.

[172] ROA001216-001217.

[173] ROA010257-010266; ROA001189. The cost of securing these judgments, which was advanced by the Cantones, totals approximately $300,000. ROA001192.

[174] ROA013599-013603.

[175] ROA014226-014227.

ignores a relevant mitigation factor necessary to determine the fair amount of sanctions (if any).[176] Beyond that, it would be a great irony for Mr. Cantone and CRI to be found to have intentionally defrauded investors - and heavily sanctioned – for (1) paying the interest out of their own pockets so that investors would receive the regular income payments they expected; and (2) gave their clients the option of exiting the investment when the project ran unexpectedly long, and the maturity was delayed. Neither CRI nor Mr. Cantone had any obligation to offer either reprieve to the investors; yet they elected to do both.

4. Applicants' desire to comply with securities rules and regulations

Additionally, the NAC improperly concluded that Mr. Cantone had not acknowledged any responsibility. At the conclusion of the FINRA examination that led to the institution of this proceeding, CRI made substantial changes in response to FINRA's suggestions.[177] This included updating the Firm's policies to "ensure full disclosure of material post-closing events to all investors."[178] CRI undertook this obligation because it "wanted to take the constructive criticism" provided by the FINRA staff, and "considered [the changes] a positive thing."[179] Indeed, all of the changes that the Firm made, including updates to its due diligence process,[180] were implemented in an effort to improve its systems.[181] Moreover, in the examination exit process, the Firm acknowledged its conduct and informed FINRA of the changes it had made.[182] The fact that Applicants challenged Enforcement's allegations is not tantamount to shirking

[176] Sanction Guidelines, Principal Considerations 4, 11, 13, 14, 16.

[177] ROA004647-004712.

[178] *Id.*

[179] ROA001604.

[180] *Id.*

[181] *Id.*

[182] ROA004647-004712.

responsibility. Indeed, several of those charges have already been dismissed below. The NAC's assessment on sanctions based on Applicants' failure to accept responsibility should be reversed.

III. CONCLUSION

For the reasons set forth herein, Applicants respectfully request that the Commission reverse the NAC's findings of liability and any sanctions imposed thereon. In the alternative, to the extent some liability is imposed, Applicants respectfully request that the Commission reduce or eliminate the sanctions imposed by the NAC so that they comport with the evidence in the record as well as FINRA's Sanction Guidelines.

Respectfully submitted this 14th day of June, 2019.

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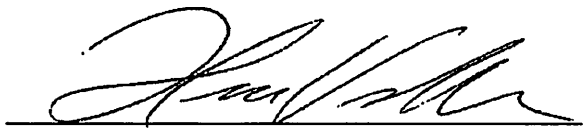
CERTIFICATE OF COMPLIANCE

In accordance with Rule 450(d) of the Rules of Practice, I certify that this brief, exclusive of the cover page, table of contents, table of authorities, and signature blocks is in compliance with the 14,000-word limit. The brief contains 13,868 words, according to the word processing system used to prepare the brief.



Heidi E. VonderHeide

CERTIFICATE OF SERVICE

I hereby certify that this **APPLICANTS' OPENING BRIEF IN SUPPORT OF APPLICATION FOR REVIEW** has been sent to the following parties entitled to notice as follows:

Securities and Exchange Commission
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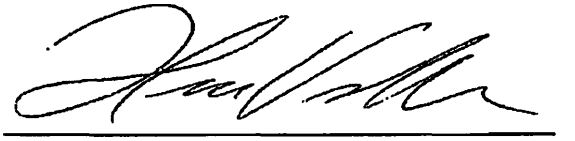
This 14th day of June 2019.



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