FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. WILLIAM H. MURPHY & CO., INC. (CRD No. 27274), and WILLIAM H. MURPHY (CRD No. 343492), Respondents.	Disciplinary Proceeding No. 2012030731802 Hearing Officer–MAD **EXTENDED HEARING PANEL DECISION** June 3, 2016

Respondent William H. Murphy & Co., Inc. violated FINRA Rule 2010 by selling unregistered securities in violation of Section 5 of the Securities Act of 1933. For this violation, William H. Murphy & Co. is fined $50,000 and ordered to disgorge $78,210.91 plus interest. Respondents William H. Murphy & Co. and William H. Murphy violated NASD Rule 3010 and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to ensure compliance with Section 5 of the Securities Act. For this violation, William H. Murphy & Co. is fined $50,000 and Murphy is (1) fined $50,000, (2) suspended from associating with any FINRA member firm in all capacities for six months, and (3) required to re-qualify by examination before he re-enters the securities industry in any capacity.

Respondents are also ordered to pay the costs of this proceeding.

Appearances

For the Complainant: Steve Graham, Esq., Penelope Brobst Blackwell, Esq., Suzanne Bertolett, Esq., and David B. Klafter, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondents: Dawn R. Meade, Esq., Bonnie E. Spencer, Esq., Ashley M. Spencer, Esq., The Spencer Law Firm, and James M. Ardoin, III, Esq., Ardoin Law PLLC, Houston, TX.

DECISION

I. Introduction

It is unlawful for a security to be sold without a registration statement in effect, unless it is sold pursuant to a valid exemption from registration.[1] From March 2011 to January 2013 (the "Relevant Period"), Respondent William H. Murphy & Co., Inc. ("WHM") participated in the sale of unregistered, non-exempt securities in three real estate investment offerings.

In March 2011, WHM began participating in a new line of business with Liberty Real Estate Advisors, LLC ("LREA"), using radio shows and workshops to sell unregistered securities for issuers of real estate investments. To do so, WHM and Respondent William H. Murphy, its President and Chief Compliance Officer ("CCO"), approved LREA as an Office of Supervisory Jurisdiction ("OSJ") and registered two of its employees as WHM registered representatives. WHM then participated in the sale of over $1 million unregistered securities for three real estate investment offerings. The offerings were sold pursuant to the registration exemption provided by the Securities and Exchange Commission ("SEC") Rule 506 of Regulation D, Section 4(a)(2) (formerly Section 4(2)) of the Securities Act of 1933 ("Securities Act").[2] However, this exemption prohibits an issuer, or anyone acting on its behalf, such as WHM, from selling securities by any form of general solicitation or general advertisement. WHM engaged in general solicitation of potential investors for the unregistered securities through the use of radio shows and workshops conducted by the LREA representatives in contravention of Section 5 of the Securities Act. WHM and Murphy also failed to establish and maintain a supervisory system, including written supervisory procedures ("WSPs"), reasonably designed to ensure compliance with Section 5 of the Securities Act.

FINRA investigated WHM's participation in the sale of the three offerings. Following its investigation, the Department of Enforcement filed a two-count Complaint against WHM and Murphy.[3] The first cause of action alleges that WHM violated FINRA Rule 2010 by engaging in sales of over $1 million in unregistered securities to 23 customers in contravention of Section 5 of the Securities Act. The second cause of action

[1] 15 U.S.C. § 77e(a).

[2] SEC Rule 506 of Regulation D is considered a "safe harbor" for the private offering exemption of Section 4(a)(2) of the Securities Act. https://www.sec.gov/answers/rule506.htm. The enactment of the Jumpstart Our Business Startups Act ("JOBS Act") on April 5, 2012, renumbered Section 4(2) of the Securities Act as Section 4(a)(2).

[3] Enforcement filed the Complaint on November 7, 2014.

alleges that WHM and Murphy violated NASD Rule 3010 and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including WSPs, reasonably designed to ensure compliance with Section 5 of the Securities Act.

Respondents filed an answer denying the alleged violations and requested a hearing.[4] Generally, WHM stated that it made a good faith attempt to comply with all applicable securities regulations. WHM also raised three specific defenses. First, WHM asserted that it did not engage in any form of general solicitation and fully complied with the Rule 506 exemption. Alternatively, WHM argued that even if its activities constituted a general solicitation, the general solicitation is eradicated because WHM established pre-existing relationships with the customers before the offer to purchase securities was extended to them. Second, WHM asserted that the three private placement offerings were exempt from registration pursuant to Section 4(2) of the Securities Act. Lastly, Respondents argued that they had an effective supervisory system in place for the supervision of the sales of the unregistered securities.

The Extended Hearing Panel rejected Respondents' defenses, found them liable for the causes of action in the Complaint, and assessed appropriate remedial sanctions.

II. Findings of Fact

A. Respondents

1. William H. Murphy & Co.

WHM is a FINRA member firm based in Houston, Texas.[5] It became a FINRA member on September 27, 1990.[6] During the Relevant Period, WHM employed 25 registered representatives.[7] It had 19 non-registered locations and two OSJ branch offices, one of which was LREA.[8] From March 2011, through June 2013, LREA was an OSJ branch of WHM.[9]

[4] The hearing was held in Houston, Texas, on December 7-16, 2015.

[5] Complainant's Exhibit ("CX-")1.

[6] CX-2, at 4. Respondents also admitted this fact. *See* Respondents' Answer ("Ans.") ¶ 81.

[7] Ans. ¶ 81.

[8] Ans. ¶ 81. WHM's LREA OSJ was also located in Houston, Texas.

[9] CX-8, at 6; CX-21; Hearing Transcript ("Tr.") 707-09, 715, 801.

2. William H. Murphy

In August 1968, Murphy registered with FINRA as a General Securities Representative.[10] He became a Registered Principal with FINRA in 1972.[11] Murphy has been associated with WHM since 1990,[12] where he serves as the firm's President, Director, and CCO.[13] At WHM, Murphy was the designated individual responsible for accepting customer accounts, and supervising all associated persons, advertising, and private placement activities.[14] As WHM's President, Murphy was also responsible for the supervision WHM's OSJ branches, including LREA.[15]

B. The Private Placement Offerings

The issuers, the 2011 Guardian Equity Fund, LLC ("GEF"),[16] the 2012 Multi Family Real Estate Fund II, LLC ("MFREF2"), and the 2012 Multi Family Real Estate Fund III, LLC ("MFREF3"), were limited liability companies ("LLCs") that intended to purchase multi-family apartments in major metropolitan areas of Texas.[17] All three issuers used the "value play" model that consisted of buying a distressed property, repairing it, holding it for a short period, and selling it.[18] They raised money through private placement offerings whereby investors purchased unregistered securities.[19] At the time of the GEF, MFREF2, and MFREF3 offerings, the issuers had no operations or sources of funds other than investor funds raised from the offerings.[20] There were no registration statements in effect or filed for the GEF, MFREF2, and MFREF3 securities

[10] CX-1, at 8; Ans. ¶ 83.

[11] CX-1, at 8; Ans. ¶ 83.

[12] CX-1, at 3; Ans. ¶ 84.

[13] CX-1, at 6; Ans. ¶ 85. Because Respondents are currently registered with FINRA, FINRA possesses jurisdiction over them under Articles IV and V of its By-Laws. Respondents also admitted that FINRA has jurisdiction over them. Ans. ¶¶ 82, 86.

[14] Joint Exhibit ("JX-")1, at 3-4. Murphy approved new accounts. JX-1, at 14. All advertising by LREA was sent to WHM for approval by Murphy. Tr. 1096.

[15] Tr. 1283-84.

[16] The GEF offering also had a component that permitted customers to invest money held in Individual Retirement Accounts ("IRAs") without losing their tax benefits. JX-7, at 2, 19. This component of the offering was referred to as Guardian Equity Fund Associates. JX-7, at 2. For the purposes of this Decision, both GEF and Guardian Equity Fund Associates will be referred to as GEF.

[17] JX-7, at 2, 68; JX-32, at 2, 69-85; CX-84, at 2; Respondents' Exhibit ("RX-")79, at 98-119; Ans. ¶¶ 91, 95, 99.

[18] Tr. 115, 689.

[19] JX-7; JX-32; CX-84.

[20] JX-7, at 18, 21, 96; JX-32, at 18-19, 108; CX-84, at 18-19.

or offerings.[21] Instead, the GEF, MFREF2, and MFREF3 private placements were offered pursuant to the Rule 506 exemption under Regulation D.[22]

During the Relevant Period, WHM participated in the GEF, MFREF2, and MFREF3 offerings. WHM was the exclusive managing placement agent and underwriter for each offering.[23] WHM received 1% of the purchase price on the securities sold in each offering as a commission.[24]

1. Guardian Equity Fund

The GEF offering period was from June 15, 2011, through May 31, 2012.[25] Between August 19, 2011, and February 23, 2012, GEF raised $1,428,775 from 26 investors.[26] Under the selling arrangement, WHM received $14,287.75 in compensation for selling securities in the GEF offering in addition to a monthly retainer fee from LREA.[27]

2. Multi Family Real Estate Fund II

The MFREF2 offering period was from May 9, 2012, through May 31, 2013.[28] Between May 30, 2012, and September 14, 2012, MFREF2 raised $1,550,488 from 43 investors.[29] Under the selling arrangement, WHM received $3,845.30 in compensation for selling securities in the MFREF2 offering in addition to the monthly retainer fee.[30]

3. Multi Family Real Estate Fund III

The MFREF3 offering period was from September 21, 2012, through September 20, 2013.[31] Between October 17, 2012, and March 18, 2013, 39 investors purchased unregistered securities in MFREF3.[32] Under the selling arrangement, WHM

[21] JX-7, at 3, 24, 42, 43; JX-32, at 3, 24, 44, 45; CX-84, at 3, 24, 44, 46.

[22] RX-74, at 3; RX-89, at 3-4; JX-40, at 4; JX-12, at 3; Ans. ¶¶ 93, 97, 101.

[23] JX-7, at 2, 13, 47; JX-12, at 2; JX-32, at 2, 13, 48-49; JX-62, at 1; JX-63, at 1; CX-84, at 2, 13, 49.

[24] JX-7, at 2; JX-32, at 2; JX-62, at 2; JX-63, at 2; CX-84, at 2; Ans. ¶¶ 53, 93, 97.

[25] JX-7, at 1.

[26] CX-46. Twenty-one of the investors were WHM customers. Tr. 253-54.

[27] CX-179.

[28] JX-32, at 1.

[29] CX-159, at 2 (16 were WHM customers).

[30] CX-179.

[31] CX-84, at 1.

[32] CX-87 (13 were WHM customers).

received $5,097 in compensation for selling securities in the MFREF3 offering in addition to the monthly retainer fee from LREA.[33]

C. Liberty Real Estate Advisors

LREA conducted radio shows and workshops to generate new customers to purchase unregistered securities in private placement offerings of its affiliates such as GEF, MFREF2, and MFREF3.[34] To accomplish this, LREA partnered with WHM.

1. Liberty Real Estate Advisors' Partnership with William H. Murphy & Co.

Originally, LREA applied for FINRA membership to become an introducing broker in connection with real estate private placements.[35] LREA submitted its FINRA membership application; however, it withdrew its application and entered into an OSJ Agreement with WHM in March 2011.[36]

As reflected in the OSJ Agreement, when WHM established LREA as an OSJ, it embarked on a new line of business, namely "market[ing] and distribut[ing] the private placements" issued by LREA's affiliates: GEF, MFREF2, and MFREF3.[37] Under this new business model, LREA and WHM were affiliated with each issuer and participated in each transaction.[38] This business model was unique because it offered workshop

[33] CX-179.

[34] CX-124; CX-138; CX-139.

[35] JX-5, at 4.

[36] CX-21. When WHM entered into the OSJ Agreement, it sought advice from its counsel on how to structure the OSJ. Tr. 1149-50.

[37] CX-21, at 1-2. An individual or entity who is not certain whether a particular product, service, or action would constitute a violation of a federal securities law may request a "no-action" letter from the SEC staff. Most no-action letters describe the request, analyze the particular facts and circumstances involved, discuss applicable laws and rules, and, if the staff grants the request for no action, concludes that the SEC staff would not recommend that the Commission take enforcement action against the requester based on the facts and representations described in the individual's or entity's request. https://www.sec.gov/answers/noaction.htm. WHM did not request a "no-action" letter from the SEC prior to participating in this new business model. Tr. 1942.

[38] Tr. 875. The private placement memoranda ("PPMs") for the three offerings identified LREA as an affiliate and stated that "[WHM] sponsors eligible employees of [LREA] to market and distribute private placements." They also identified the LREA employees that were registered representatives of [WHM], the Managing Placement Agent. JX-7, at 95; JX-32, at 97; CX-84, at 129. In addition, all of the subscription agreements and purchaser questionnaires identified LREA as a party to each of the transactions at issue in this matter. *See* JX-8, JX-35; JX-36; CX-84. Every investor made representations to the issuers, WHM, and LREA "in connection with the securities transaction," including an agreement that the customer would indemnify and hold all of those entities harmless for representations made in connection with the securities transactions. JX-8, at 28, 35, 37, 50, 54, 55, 84, 91, 93-94, 107, 111-12; JX-35, at 2, 9, 11-12; JX-36, at 2, 6-7; CX-84, at 178, 185, 187-88, 201, 205-06. The issuers and WHM also maintained offices at LREA. Tr. 733, 1097-98, 1100-01.

attendees a service that no other real estate workshop did—a broker-dealer to sell workshop attendees unregistered securities.[39]

Murphy expected that 5% to 10% of the workshop attendees would meet with a WHM representative, who worked out of the LREA office, to passively invest in private placements.[40] Murphy also expected that these attendees would become investors in the private placements, helping the issuers raise funds.[41] At the time of the offerings, LREA and the issuers had no operations or sources of funds other than investor funds raised from the offerings. As such, investors were needed to fund LREA and the issuers' operations.[42] As one LREA representative explained, LREA relied on funds generated from selling unregistered securities to "keep the lights on."[43]

Under the OSJ Agreement with LREA, LREA paid all expenses relating to the OSJ arrangement and a monthly retainer fee to WHM.[44] During the Relevant Period, LREA initially paid WHM $2,666.67 per month as a retainer fee; the retainer fee increased to $4,000 per month in July 2012.[45] The payment of the fee was contingent on WHM's commissions. The commissions could be reimbursed to LREA or waived by WHM if the commission on the sales of the unregistered securities in the private placement offerings exceeded the retainer fee.[46] WHM received a total of $54,980 in retainer payments while participating in the sales of the securities of the three offerings at issue.[47]

WHM and LREA entered into a Joint Client Service Agreement ("Agreement") in connection with the OSJ Agreement.[48] Similar to the OSJ Agreement, the Agreement established a partnership between WHM and LREA to participate in the sales of

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[39] Tr. 50.

[40] RX-194, at 22.

[41] RX-194, at 53-54. Murphy negotiated WHM's fees and commissions with LREA and the issuers based on his expectation that the radio shows and workshops would generate new customers for WHM to whom it would sell the affiliated issuers' unregistered securities. RX-194, at 22.

[42] Tr. 196-97, 826.

[43] Tr. 398 (One LREA employee testified that if someone asked her how LREA kept its lights on, she would tell them that she could meet with them in her WHM capacity.); JX-70, at 6-7 (script used by LREA speakers at meetings that answered attendees' questions about "how [LREA] keeps the doors open" by telling them that there "was an affiliate company that offers multi-family opportunities for those who are deemed suitable by our third party broker-dealer, William H. Murphy… if you have $50,000 or more of investable capital, we recommend speaking with a registered rep of our third party broker-dealer to see if multi-family is suitable for you").

[44] CX-21, at 14; Ans. ¶ 106.

[45] CX-21, at 14; CX-179.

[46] CX-21, at 14.

[47] CX-179.

[48] CX-21; CX-182, at 19-26.

securities in specific securities offerings. The Agreement stated that LREA would provide "educational services related to multifamily investing" and contemplated that LREA may "offer[] securities to investors of related issues of securities" with the assistance of WHM.[49] The "Services to be Rendered" section of the Agreement enumerated two services to be jointly provided by WHM and LREA: (1) structuring and preparing offering documents and (2) securities activities.[50]

Throughout the hearing, Respondents downplayed LREA's role in connection with the sales of the unregistered securities. They claimed that LREA's primary function was to provide educational real estate classes to compete with another entity that offered such classes.[51] In support of this position, the Respondents cited to an Amended Joint Client Services Agreement ("Amended Agreement").[52] The Amended Agreement changed the Agreement substantially. First, it described LREA as "primarily" an educator and removed any language reflecting that LREA may offer securities to investors.[53] Second, under the "Services to be Rendered" section of the Amended Agreement, any reference to "jointly" providing securities-related services was removed and a new third category of services titled "Educational Activities" was added.[54] The Amended Agreement limited LREA's activities to educational activities.[55]

The Amended Agreement was signed by Murphy but undated.[56] It stated that it was "effective as of March 15, 2011," the date of the original Agreement.[57] Murphy could not recall when he signed the Amended Agreement, but WHM's counsel testified that he drafted the Amended Agreement for Murphy's signature in February 2013, nearly two years after LREA became an OSJ branch of WHM.[58] WHM's counsel recalled that he drafted the Amended Agreement during the time that FINRA was investigating this matter and preparing to take the testimony of WHM's registered representatives.[59] He amended the Agreement after the Spencer Law Firm (Respondents' counsel in this proceeding and counsel for LREA and the issuers) brought it to his attention.[60]

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[49] CX-182, at 19.

[50] CX-182, at 20.

[51] Tr. 767.

[52] RX-55.

[53] *Compare* CX-182, at 19 *with* RX-55, at 1.

[54] RX-55, at 2.

[55] RX-55, at 2.

[56] RX-55, at 6. Murphy did not see Trey Stone sign the Amended Agreement on behalf of LREA. Tr. 1378.

[57] RX-55, at 1, 6.

[58] Tr. 1380, 1940.

[59] Tr. 1940.

[60] Tr. 103, 329, 618, 751-52, 1141, 1273, 1940-41; CX-14, at 4; RX-62.

Respondents provided Enforcement with the Agreement in mid-October 2012, less than four months before it created the Amended Agreement.[61] However, Respondents never provided Enforcement with the Amended Agreement at any time during its investigation. Enforcement first received the Amended Agreement when Respondents filed their proposed exhibits with the Office of Hearing Officers in preparation for the hearing.[62] Although the Amended Agreement was contained within Respondents' exhibits, Respondents' exhibit list and pre-hearing brief did not indicate that the Agreement had been amended; rather, both the exhibit list and the pre-hearing brief continued to refer to the Amended Agreement as the "Joint Client Service Agreement," the original Agreement, without disclosing that it had been amended.

The Panel did not find the testimony regarding LREA's primary function as stated in the Amended Agreement to be credible. The Panel also found the timing of the creation of the Amended Agreement, as well as the lack of full disclosure and candor to Enforcement and the Panel, to be troubling.

2. Liberty Real Estate Advisors' Relationship with the Issuers

LREA was affiliated with the issuers, and Murphy was fully aware of this affiliation.

Before entering into the OSJ Agreement with LREA, Murphy met with LREA's owner, Trey Stone, and LREA's outside counsel, The Spencer Law Firm (the same law firm representing Respondents in this proceeding).[63] During the initial meeting, Murphy learned about the business model and the issuers.[64] Murphy knew that Stone was both the owner of LREA and the owner of the property management company for GEF.[65] Murphy and Stone discussed the process of obtaining customers, educating them, qualifying them, and sending them to the issuers.[66] During subsequent meetings, they discussed more of the specifics such as the radio shows and workshops.[67] Murphy believed that Stone was going to create a lucrative business.[68]

Below we discuss LREA's owners and employees (some of whom were registered at WHM), highlighting LREA's relationships with the issuers of the GEF, MFREF2, and MFREF3 offerings.

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[61] CX-182, at 1, 19-26.

[62] Tr. 1406.

[63] Tr. 1141.

[64] Tr. 1144-46.

[65] Tr. 1160-61.

[66] Tr. 1156.

[67] Tr. 1157.

[68] Tr. 1158-59.

a. Trey Stone

Trey Stone, a non-registered individual, owned LREA.[69] From July 28, 2011, through the end of the Relevant Period, he was President of LREA.[70] In some instances, Stone met with WHM customers on behalf of the issuers to sell them the securities at issue.[71]

Stone managed, directly or indirectly, the three private placement offerings at issue: GEF, MFREF2, and MFREF3.[72] Stone controlled the daily operations of GEF, MFREF2, and MFREF3.[73] In addition, he owned Guardian Equity Management, LLC ("GEM"), the property management company for GEF.[74]

For all of the 23 customers at issue who purchased unregistered securities in the GEF, MFREF2, and MFREF3 offerings, Stone signed the subscription documentation, accepting the subscription on behalf of the issuers.[75]

b. Mindy Price

Mindy Price was a registered representative of WHM who worked in the LREA OSJ office from March 15, 2011, until August 24, 2012.[76] Price was also employed by LREA as the Vice President of Business Development and later an Executive Vice President.[77] Price explained that she was a dual employee who was "always wearing two hats": one in connection with her LREA responsibilities and the other in connection with her WHM responsibilities.[78] To fulfill her LREA role, Price hosted radio shows and conducted workshops for the general public about real estate investments. One purpose of

[69] Ans. ¶ 88.

[70] CX-23. Gary Blumberg ("Blumberg") was the President of LREA from March 15 through July 28, 2011. CX-21, at 12; CX-24.

[71] Tr. 386.

[72] The GEF PPM identifies Stone as the manager. JX-7, at 11, ¶ 14; Ans. ¶ 88. In the MFREF2 and MFREF3 PPMs, Stone was identified as the President and CEO of the managing company that was wholly owned and managed by a company wholly owned and managed by Stone. JX-32, at 14; CX-84, at 13.

[73] JX-7, at 22-23; JX-32, at 23-24; CX-84, at 23-24; RX-36, at 4; RX-37, at 3 (article 3.01); RX-41, at 4; RX-44, at 2; RX-48, at 4. Respondents admitted that GEF, MFREF2, and MFREF3 LLC interests were securities. Ans. ¶¶ 94, 98, 102.

[74] CX-84, at 123; JX-7, at 14. Blumberg was the Chief Investment Officer of GEM from 2008 through 2013. Tr. 1604-05; JX-7, at 88; JX-32, at 90; CX-84, at 123.

[75] JX-20, at 56; JX-22, at 31; JX-23, at 32; JX- 24, at 32; JX-25, at 31; JX-26, at 32; JX-27, at 32; JX-28, at 32; JX-29, at 31; JX-30, at 31; JX-31, at 40; JX-41, at 33; JX-42, at 31; JX-43, at 18; JX-44, at 17; JX-45, at 37; JX-46, at 33; JX-47, at 34; JX-49, at 15; JX-51, at 33; JX-53, at 31; JX-56, at 36; JX-58, at 30.

[76] CX-7, at 3; Tr. 42, 74-75. Although Price was registered with WHM, she did not have a WHM email address, only a LREA email address. Tr. 306.

[77] Tr. 54-55, 58, 124-25; JX-73; CX-20.

[78] Tr. 84.

the radio shows and workshops was to find individuals interested in passively investing in real estate and establish them as new customers of WHM. As part of her WHM duties, Price met these potential investors to qualify them for investing in the GEF and MFREF2 offerings, which included filling out new account forms. As Price explained, "I was always wearing two hats when I would meet these individuals and learn about what their goals were."[79]

The only securities that Price was approved to sell were the affiliated issuers' unregistered securities.[80] When the individuals invested in one of the private placements through WHM, Price received a commission on the sales.[81]

c. Mark Hutton

Mark Hutton was a registered principal of WHM who worked out of the LREA OSJ office from March 15, 2011, until July 31, 2013.[82] Like Price, Hutton was a dual WHM and LREA employee. At LREA, Hutton was the Compliance Officer.[83] In her LREA role, Price supervised Hutton; however, Hutton was the WHM principal designated to supervise Price in their WHM roles.[84] LREA paid Hutton a salary; however, he received no salary from WHM despite his principal capacity with the firm and responsibility for supervising the LREA OSJ branch.[85]

As the registered principal for the LREA OSJ, Hutton was responsible for reviewing and approving Price's securities transactions.[86] From March 15, 2011, until August 24, 2012, Hutton conducted suitability reviews for the new WHM customers who completed a new account form after meeting with Price.[87] After Price left WHM, Hutton assumed Price's responsibilities for meeting with potential investors derived from the

[79] Tr. 84. The Panel found that the above testimony from Price was an accurate depiction of how she conducted herself, "always wearing two hats." At other points during the hearing, Price changed her testimony on this point. She conformed her testimony to the narrative put forth by Respondents that LREA was completely separate from WHM. For example, Price testified, "I did not put my broker-dealer hat on at the workshops." Tr. 161.

[80] Tr. 73-74, 690; JX-64, at 1-2; JX-65, at 1-2.

[81] JX-65, at 3; Tr. 73, 320, 682. LREA accepted transaction-based compensation from the sale of the unregistered securities. Price testified that she had to give 80% of the commissions she received from WHM to LREA. Tr. 682. Mark Hutton, Price's WHM supervisor, confirmed that a portion of Price's commissions from WHM went to LREA. Tr. 1125. Price also received a salary from LREA for conducting the radio shows and workshops. Tr. 55; JX-73.

[82] CX-8, at 3. Although Hutton was registered with WHM, he did not have a WHM email address. He only had a LREA email address. Tr. 1046.

[83] Tr. 720; Ans. ¶ 90.

[84] Tr. 60, 721, 727-28, 750.

[85] Tr. 720, 728; JX-64, at 3; Ans. ¶ 90.

[86] Tr. 737-38.

[87] Tr. 737-38.

radio shows and workshops to qualify them for investing in private placements with WHM.[88] Like Price, the only securities that Hutton was approved to sell were the affiliated issuers' unregistered securities.[89] WHM paid Hutton a commission on the sales of private placements to customers that Hutton qualified from the radio shows and workshops.[90]

d. David Fantin

David Fantin was employed by LREA as an Executive Vice President beginning in April 2012, and became the "face of LREA" after Price left.[91] He was also employed by GEM and the issuers.[92] Fantin was featured on videos posted on LREA's website.[93] In addition, he taught or attended different workshops where the issuers' business model was discussed.[94] Fantin sometimes met with WHM customers on behalf of the issuers to sell them the securities in the offerings at issue.[95]

e. Bryan Upton

Bryan Upton was employed by LREA as Vice President of Business Development beginning in 2011.[96] He was also employed by GEM and the issuers.[97] Like Fantin, Upton was featured on videos posted on LREA's website, he taught or attended different workshops, and he met with WHM customers on behalf of the issuers to sell them securities in the offerings.[98]

D. Marketing the Private Placement Offerings

The marketing strategy used by the issuers and its affiliates, including WHM and LREA, included radio shows and workshops to find new investors for the offerings in

[88] Tr. 863, 997, 1092.

[89] Tr. 941-42; JX-64, at 1-2; JX-65, at 1-2.

[90] Because Hutton did not start qualifying WHM customers until Price left LREA, WHM only paid Hutton a commission on the sales of MFREF2 and MFREF3 securities, which were the offerings that remained when Price left. Tr. 722-23; JX-64, at 3; Ans. ¶ 90.

[91] Tr. 113, 557, 1109.

[92] JX-32, at 88, 97; CX-84, at 121-22, 129.

[93] Tr. 688-89, 695-98, 760, 787, 1109-10, 1115; CX-105.

[94] Tr. 272, 687-88, 698.

[95] Tr. 386-87.

[96] Tr. 59.

[97] JX-32, at 88, 90; CX-84, at 121-22, 129; Tr. 375.

[98] Tr. 272, 385-86, 392, 687-88, 695-98, 760, 787, 1109-10, 1115; CX-105; CX-139.

GEF, MFREF2, and MFREF3.[99] LREA conducted radio shows and commercials that encouraged listeners to attend a free workshop regarding real estate investment opportunities.[100] During each radio show and at each workshop, WHM representatives read a disclosure that securities were offered through WHM.[101] The disclosure indicated that listeners and attendees could purchase securities from WHM, if interested.[102] The disclosure was necessary because WHM intended to obtain new customers from the radio shows and workshops.[103] If any workshop attendee expressed an interest in investing, a one-on-one meeting was set up with a WHM representative, Price, or Hutton.

1. Radio Shows and Commercials

LREA used radio talk shows and commercials to obtain investors.[104] The radio shows were predominately conducted by Price.[105]

LREA's business plan stated: "[LREA's] radio talk shows will be aired to the general public and focused on real estate as an investment vehicle … the shows will feature strategies for participants struggling to find alternatives to the stock market who

[99] Tr. 86-88, 1076-77. Respondents' witnesses and counsel also referred to this as the "chain of general solicitation" and "chain of solicitation." Tr. 244-45, 268, 877, 880, 1253, 1462-63, 1812, 1934. JX-5, at 3 (LREA's business plan) (stating that its "initial mission is to launch a successful media campaign to market its services to potential clients and build a strong and suitable clientele … [and] the ongoing mission … will be to introduce prequalified and suitable clients to associated issuers of private placements….").

[100] LREA representatives testified that LREA intended on charging for the workshops. Tr. 767. However, LREA offered free workshops throughout the Relevant Period. Free classes were offered at least through April 10, 2013. *See* CX-26 (LREA's website promoting free classes).

[101] JX-68; JX-69; CX-14, at 18, 20 (¶¶ 3.6, 4.6); CX-95; CX-95A, at 37; CX-97; CX-97A, at 34; CX-101; CX-101A, at 15, 31, 36-37, 47; CX-102A; CX-102B; RX-65, at 14 (¶ 3.2.2); RX-99; Tr. 155, 216, 577, 792, 1229. After the first radio show, Murphy received over 50 phone calls asking when WHM entered the real estate business. RX-194, at 21; Tr. 1229.

[102] The radio disclaimer stated, "Securities sold through William H. Murphy and Company, Incorporated, a registered broker-dealer, member FINRA and SIPC …." CX-95A, at 37; CX-97A, at 34; CX-101A, at 15, 31, 36-37, 47. The workshop disclaimer stated, "Securities transactions are conducted by certain employees of Liberty Real Estate Advisors, LLC that are also registered through Wm. H. Murphy & Co., Inc., Member FINRA/SIPC." CX-14, at 17-18 (¶ 3.6). Another workshop disclaimer stated, "Once you have decided real estate is an investment option for you, we can then set up an appointment with Mindy Price or one of the other registered representatives at Wm. H. Murphy and Co. to see if you qualify and meet the suitability requirements for this type of investment." RX-65, at 14-15 (¶ 3.2.2). LREA's website also contained the disclaimer that securities were offered through WHM. CX-26, at 5.

[103] Tr. 1155-56, 1314. Respondents claim that the only purpose of the radio shows and workshops was to educate the public about real estate investments. However, there would be no need for a disclaimer about securities offered through WHM if generating customers for securities solicitation was not an objective. There would also have been no need to have WHM registered representatives on site at LREA and negotiate a commission for securities sales if sales were not intended.

[104] JX-5; Tr. 64.

[105] Tr. 90. On occasion, Hutton co-hosted the radio shows with Price. Tr. 1047. On those occasions, he might be wearing his LREA hat or his WHM hat, or both. Tr. 1047. LREA's website contained podcasts of the radio shows. Tr. 236.

lack expertise in real estate or desire to enhance their expertise."[106] The radio shows were (1) broadcast over the airways;[107] (2) placed on LREA's website as podcasts and available for listening over the Internet;[108] and (3) sent by Price to potential investors via email as podcast links.[109]

The radio shows sparked the investors' interest and got them to the workshops.[110] The radio shows discussed:

- an alternative to traditional investing;[111]
- adding real estate investments to the listener's portfolio;[112]
- good time to invest in apartments;[113]
- passive investments;[114]
- private placements;[115] and
- free workshops provided by LREA that listeners could attend to learn more about investing in real estate.[116]

Although the GEF, MFREF2, and MFREF3 offerings were not mentioned by name, Price discussed her personal investment in GEF on the radio and talked about how great it was to invest in an apartment complex.[117]

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[106] JX-5, at 12.

[107] Tr. 92. Radio commercials were also broadcast over the airways. Tr. 177-80.

[108] Tr. 235-36.

[109] Tr. 235-36. WHM registered representatives communicated with investors via email and the telephone. Tr. 163, 215, 236; CX-108A (notes section of the "all attendees" tab and "break down on status" tab); CX-111; CX-118; CX-151A (SUGAR Accounts tab, column BL). Price also emailed the radio shows podcasts that LREA maintained on its website to investors. Tr. 235-36.

[110] Tr. 101.

[111] CX-95A, at 2, 4, 23; CX-97A, at 2.

[112] CX-95A, at 2, 8, 12, 18-20, 23; CX-97A, at 2.

[113] CX-95A, at 17-18.

[114] CX-95A, at 26-27.

[115] CX-95A, at 30-33.

[116] CX-95A, at 9-12, 19, 26, 29-30, 33, 36; CX-97A, at 4, 11, 19, 25, 27, 33; CX-101A, at 14, 18, 30, 35-36, 46.

[117] CX-101A, at 22-24, 32-33; Tr. 447-48. Price testified that she did not mention any specific securities that were open during the radio shows. Tr. 640.

The radio commercials that aired every week also touted the free workshops.[118] They encouraged investors to learn more and invest, stating:

- we've determined a lucrative trend;
- millionaires have real estate in their portfolio;
- look at what's in your portfolio;
- buy low and sell high, right now apartments are low; and
- look at apartments.[119]

The radio shows and radio commercials were effective marketing tools. More than 300 individuals attended the workshops after listening to the radio shows.[120] For the 23 new WHM customers at issue in the Complaint, the radio shows initiated the process that led to the person becoming a new customer of WHM.[121]

2. Workshops

Price also presented workshops to potential investors two to three times a week during the Relevant Period.[122] During the Relevant Period, 313 individuals who listened to the radio shows subsequently attended a workshop.[123] Like the radio shows, the purpose for the workshops was to attract potential customers to invest in the private placement offerings.[124] WHM, through Murphy, permitted Price to conduct workshops during the time periods that the GEF, MFREF2, and MFREF3 offerings were already open.[125] Both LREA and WHM considered the workshops to be "sales pitch[es]."[126]

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[118] JX-29; JX-68; Tr. 177-82, 291.

[119] JX-29; JX-68; Tr. 177-82, 291.

[120] CX-135A (SUGAR – Accounts tab, column Y).

[121] *See* JX-22, at 1; JX-23, at 1; JX-24, at 1; JX-25, at 1; JX-26, at 1; JX-27, at 1; JX-28, at 1; JX-29, at 1; JX-30, at 1; JX-31, at 1; JX-41, at 1; JX-42, at 1; JX-43, at 1; JX-44, at 1; JX-45, at 1; JX-46, at 1; JX-47, at 1; JX-49, at 1; JX-51, at 1; JX-53, at 1; JX-56, at 1; JX-58, at 1.

[122] Tr. 122, 130, 1265.

[123] CX-135A (SUGAR – Accounts tab, column Y). LREA and WHM used the Customer Relationship Manager ("CRM") system to track information about each customer. Tr. 522-25. LREA recorded information into its CRM system for everyone that attended a workshop. Tr. 525-26. CRM was later converted to another system called SUGAR that was accessible by Hutton and Murphy. Tr. 686-87.

[124] JX-5.

[125] Tr. 1221-22.

[126] JX-67, at 5. Murphy approved all advertising, including the scripts used by LREA. Tr. 1265-66, 1269-71.

When Price conducted the workshops, she followed a detailed script, which Murphy reviewed and approved.[127] The workshop attendees were provided with information about investing in real estate as a means of generating income.[128] At the workshops, Price explained that LREA had "come up with an investment vehicle that has allowed many investors to achieve returns that can exceed what your more traditional forms of investing have typically been able to deliver."[129] She further explained that LREA was focused on educating the public about investing in apartments through private placement offerings, which she described as an alternative to traditional 401(k) and IRA investments like stocks, bonds, and mutual funds.[130] Price described private placements, the criteria for determining accredited investor status, and limits placed on non-accredited investors who want to invest in private placements.[131] She repeatedly touted the benefits of passively investing in apartment complexes.[132] She simultaneously highlighted the downsides of owning single family rental properties and apartments by using the phrase "tenants, toilets, and taxes" and describing owning real estate as "a full-time job" or a second job.[133] Price provided the workshop attendees with examples of how they could

[127] Tr. 123, 695, 1265-66, 1269-71. Throughout the hearing Respondents had trouble identifying what was a final, approved script. Respondents did not provide evidence of an approved advertising file. Hutton testified that to locate a final version he would "follow that trail of the e-mail to making sure that whatever the ultimate final approval was, was the one that was actually used." Tr. 1093.

Although Respondents produced a non-redlined workshop script to Enforcement during its investigation, at the hearing, Price asserted that JX-67, an introductory workshop script, was an "old document[] that did not go live." Tr. 118-19, 121, 146. Although Murphy testified that he reviewed and approved the workshop script identified as JX-67 and that it was the script Price used at a workshop that Murphy personally attended, Tr. 1265-66, 1269-71, Price testified that JX-67 was not the script she used because the copyright date in the footer was 2010. Tr. 118-19. The day before the hearing ended, Respondents produced for the first time RX-242, which they claimed was the "final" script used by Price at the introductory workshop. Tr. 1744-52, 1756-59. RX-242 was a red-lined version of a script that was attached to an email, which stated that the script contained suggested changes. RX-242. Moreover, RX-242 also had a copyright date of 2010 in the footer. RX-242, at 2. There was no documentary evidence that RX-242 was a final, approved workshop script. The Panel finds that Price's testimony regarding JX-67 was inaccurate. Nonetheless, her recollection of what she covered in the workshops was consistent with the content of JX-67. Tr. 126-28, 131-33.

Respondents also asserted that CX-27, the Quick Start Workshop presentation, never went live. They later compared CX-27 to one of their proposed exhibits, RX-93, and determined that it was identical to their proposed exhibit. Tr. 789-92. Respondents did not offer proposed exhibit RX-93 into evidence.

[128] JX-5, at 13.

[129] JX-67, at 5.

[130] JX-67, at 1. Although Respondents stated that LREA's primary function was educating investors in real estate, the script stated that the education was provided to help attendees overcome their fear of what they would be investing in. JX-67, at 13.

[131] JX-67, at 14-16.

[132] JX-67, at 1, 5, 8, 9, 16, 32.

[133] JX-67, at 9, 12, 20, 21, 23, 29. There was also a script for a Quick Start workshop that touted passive investments with an affiliated company. CX-27, at 3.

generate a tax deferred 55% annual return,[134] and achieve an "infinite" return through net operating income.[135]

Workshops at LREA also were conducted by employees of GEM, the issuers' management company.[136] These GEM employees were also LREA employees.[137] According to Price: "When they were teaching those classes, they were teaching in the capacity of a Liberty Real Estate Advisors employee. And they were not allowed to talk about any business on the Guardian Equity Management side."[138]

At the workshops, attendees filled out a Contact Information Form with their general contact information, the date of the workshop, and an indication of whether they wanted "additional information."[139] The form did not collect information on an attendee's financial background or investment experience.[140] Murphy prohibited Price and Hutton from asking attendees about their financial background and investment experience at the workshop.[141]

The Contact Information Form also contained the phrase, "Real Investments. Real People. Real Results." The form advised attendees that "[s]ecurities transactions are conducted through Wm. H. Murphy & Co., Inc."[142] At the end of each workshop, a WHM representative informed attendees that they could meet with a registered representative about passive investment opportunities.[143] If a seminar attendee was interested in passive investments, the attendee would set up a meeting for a later date with either Price or Hutton in their capacity as a WHM registered representative.[144]

The workshops were an effective marketing tool. They created an interest in passively investing in real estate and encouraged attendees to meet one-on-one with a WHM representative, Price, or Hutton to learn more about passively investing.[145] In fact, 92 radio show listeners who attended a workshop subsequently scheduled one-on-one

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[134] JX-67, at 31.

[135] JX-67, at 31.

[136] Tr. 687.

[137] Tr. 687.

[138] Tr. 687.

[139] Tr. 700; *see, e.g.*, JX-24, at 1.

[140] *See, e.g.*, JX-24, at 1.

[141] Tr. 1250.

[142] *See, e.g.*, JX-24, at 1.

[143] Tr. 631-32; RX-65, at 14-15 (¶ 3.2.2).

[144] Tr. 46, 700, 1252; Ans. ¶¶ 89, 90.

[145] JX-67, at 14, 33.

meetings with a WHM representative.[146] All of the WHM customers at issue attended the workshops.[147]

3. One-on-One Meetings

If a workshop attendee wanted to meet a WHM registered representative, LREA set up a one-on-one meeting with Price or Hutton. These meetings were held in Price's office, which was a WHM office located at LREA,[148] where Price or Hutton would discuss the prospective customer's real estate experience and other financial matters.[149] They would also have the customer complete a WHM new account form.[150] The new account form requested information about the customer's financial status and investment experience.[151] The completion of the new account form was the first time LREA and WHM obtained financial information from the prospective customer.[152] Approximately two-thirds of the prospective customers who attended the one-on-one meetings completed the new account form during their meeting with a WHM representative.[153]

E. Review and Approval of the William H. Murphy & Co. New Account Form

For Price's new customers, Hutton reviewed the new account forms to determine whether they were suitable for private placement offerings and then approve them in his capacity as a WHM principal.[154] After Price left WHM, prospective customers met with Hutton for the suitability review, and the new account forms were then sent to Murphy for principal review and approval.[155]

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[146] CX-13.

[147] Tr. 212, 692, 1314. None came solely from the radio shows without attending a workshop. Tr. 70, 86.

[148] Tr. 682, 963-64, 1102.

[149] Tr. 701.

[150] Tr. 69, 700. The WHM new account form was always readily available on Price's desk during the one-on-one meetings. Tr. 169-70.

[151] *See, e.g.*, CX-26.

[152] Tr. 1250.

[153] Tr. 170.

[154] Tr. 701, 1104.

[155] Tr. 723, 735.

None of the 23 new WHM customers at issue had a relationship with WHM prior to attending the one-on-one meeting and completing the WHM new account form.[156] In fact, Murphy refused to offer the unregistered securities to his existing customers.[157]

F. Sales of Unregistered Securities

After a WHM principal approved the new account form, the customer was referred to a representative of one of the issuers, GEF, MFREF2, or MFREF3.[158] Before WHM referred a customer to the issuers, it satisfied a waiting or cooling-off period.[159] Murphy mandated that the cooling-off period begin on the date the new WHM customer had completed the Contact Information Form.[160] WHM's policy was not to refer customers to the issuers until 30 days after they completed the Contact Information Form at the workshops.[161] When the WHM customers met the issuers, a non-registered individual employed by the issuer funds would complete the sale of the securities and Price or Hutton would receive a commission from WHM.[162]

During the Relevant Period, 23 individuals listened to the radio shows, attended the workshops and one-on-one meetings, became WHM customers, and purchased securities in the offerings.[163] These 23 customers purchased a total of 125.26 units of the

[156] Ans. ¶ 111; CX-135A (SUGAR Accounts tab, column CE); Tr. 807-09. Both Hutton and Price testified that a "1" in the "pre-existing relationship" column on CX-135A meant "yes" and "0" meant "no". Tr. 364, 528, 807. Nearly every customer on the CRM, including the 23 at issue in this matter, had a "0" in the pre-existing relationship column. CX-135A (SUGAR Accounts tab, column CE). Murphy testified that customer data in CX-135A was consistent with his refusal to offer the unregistered securities at issue to his existing customers. Tr. 1314.

[157] Tr. 1314.

[158] Tr. 305, 702.

[159] WHM asserts it established a substantive relationship and began calculating the cooling-off period as of the date the person attended a workshop, Tr. 630, 697, 1249-50; RX-65, at 15 (¶ 3.2.3); however, at the time of the workshop, the firm had no information about the potential customer's financial background, investing experience, or other information required to establish a substantive relationship. Tr. 89. According to Respondents, the cooling-off period "breaks the chain of solicitation." Tr. 244-45, 268, 877-78, 880-81, 1253, 1462-63, 1812, 1934.

[160] Tr. 1075. As Hutton explained, attendance at a workshop and completion of the Customer Information form signified the start of the "customer journey." Tr. 1075-76.

[161] Tr. 633-34, 1804. Murphy testified that there were two cooling-off periods. The first cooling-off period ran from the date workshop attendees completed the Contact Information Form. The second cooling-off period ran from the date that they met with a WHM representative at the one-on-one meeting. Tr. 1252-53. Hutton tracked the cooling-off periods using information from the CRM system. Tr. 535, 539.

[162] Tr. 386-87, 457, 671-72, 697-98, 871; RX-194, at 70, 78-79, 94. Investors wired funds to the issuers' bank accounts and faxed information to the issuers. CX-48, at 4; CX-53, at 1; CX-83, at 18; JX-20, at 34-35.

[163] Tr. 1427-29; CX-180; CX-46; CX-81, at 44-45; JX-51, at 2-6, 24; JX-53, at 2-6, 22; JX-56, at 2-6, 27; JX-58, at 2-5, 21.

GEF, MFREF2, and MFREF3 offerings for a total of $1,031,700.[164] Each offering was open before the customer completed the WHM new account form and became a WHM customer.[165]

The tables below reflect the customers that purchased the unregistered securities in each of the three offerings at issue and provide details regarding each purchase.

1. Guardian Equity Fund

On June 15, 2011, the GEF offering opened.[166] WHM thereafter referred 11 of the GEF investors (five of whom were unaccredited)[167] to GEF.[168]

Customer	Date	NAF Date	Transaction Date	Purchase Amount	Accreditation Status
RP	04/07/2011	09/14/2011	11/18/2011	50,000	Unaccredited
BR	06/26/2011	07/12/2011	09/12/2011	84,000	Accredited
TK	03/30/2011	07/13/2011	10/05/2011	25,000	Accredited
GF	07/16/2011	07/21/2011	08/29/2011	50,000	Accredited
OS	07/16/2011	07/22/2011	10/04/2011	40,000	Unaccredited
RM	07/28/2011	08/11/2011	09/30/2011	75,000	Unaccredited
PS	08/25/2011	08/30/2011	01/19/2012	40,000	Accredited
JH	09/01/2011	09/09/2011	11/01/2011	71,200	Unaccredited
TB	09/10/2011	01/07/2012	01/16/2012	20,000	Unaccredited
JL	11/17/2011	11/17/2011	01/12/2012	50,000	Accredited
DM	12/08/2011	12/13/2011	01/23/2012	40,000	Accredited

[164] JX-20, at 25, 48; JX-22, at 23; JX-23, at 24; JX-24, at 24; JX-25, at 23; JX-26, at 24; JX-27, at 24; JX-29, at 23; JX-30, at 23; JX-31, at 32; JX-41, at 24; JX-51, at 24; JX-53, at 22; JX-56, at 27; JX-58, at 21; CX-81, at 44-45; CX-180.

[165] *Compare* JX-7, at 1; JX-32, at 1; CX-84, at 1 (reflecting opening date of the offering) *with* CX-180 (transaction date for the 23 customers) and RX-188 (subscription date for the 23 customers); *see also* Ans. ¶ 111 (admitting that none of the 23 customers had a pre-existing substantive relationship with WHM before listening to the radio show and attending a workshop).

[166] JX-7, at 1; CX-180.

[167] CX-180.

[168] CX-180.

2. Multi Family Real Estate Fund

On May 9, 2012, the MFREF2 offering opened.[169] WHM thereafter referred eight of the MFREF2 investors (four of whom were unaccredited)[170] to MFREF2.[171]

Customer	Date	NAF Date	Transaction Date	Purchase Amount	Accreditation Status
MS	02/28/2012	08/13/2012	09/14/2012	25,000	Accredited
AR	05/08/2012	05/29/2012	08/30/2012	45,000	Unaccredited
DS	05/08/2012	06/14/2012	07/23/2012	10,000	Accredited
CW	06/11/2012	07/03/2012	08/28/2012	20,000	Unaccredited
DN	07/10/2012	07/26/2012	09/14/2012	50,000	Unaccredited
MG	07/21/2012	07/31/2012	09/14/2012	25,000	Accredited
DB	08/01/2012	08/03/2012	09/14/2012	30,000	Unaccredited
MF	08/09/2012	09/06/2012	09/14/2012	30,000	Accredited

3. Multi Family Real Estate Fund

On September 21, 2012, the MFREF3 offering opened.[172] WHM thereafter referred four of the MFREF3 investors (one of whom was unaccredited)[173] to MFREF3.[174]

Customer	Date	NAF Date	Transaction Date	Purchase Amount	Accreditation Status
RT	08/22/2012	01/29/2013	02/26/2013	26,000	Unaccredited
AM	10/18/2012	10/26/2012	11/26/2012	100,000	Accredited
JG	10/22/2012	10/22/2012	12/17/2012	100,000	Accredited
GR	11/13/2012	12/12/2012	01/09/2013	25,000	Accredited

G. Tracking the Ideal Client

LREA used data from its internal systems to identify its "ideal client."[175] Because its marketing methods were expensive, it was necessary to identify which methods were

[169] JX-32, at 1; CX-180.

[170] CX-180.

[171] CX-180.

[172] CX-84, at 1; CX-180.

[173] CX-180.

[174] CX-180.

[175] CX-124; Tr. 406-07.

most successful.[176] Stone, LREA's owner and the manager of the issuers, hired an outside consultant to analyze the attendees to track the "ideal client."[177] Although Respondents claimed that LREA's primary purpose was education, LREA's "ideal customer" analysis did not focus on anything education-related. For example, it did not include a breakdown by each workshop to determine which had the most attendance, trends in attendance, or feedback from attendees to see what the attendees found most helpful and their goals with real estate investing.[178] Instead, LREA limited its "ideal client" analysis to *only* workshop attendees that purchased securities in the offerings.[179] Its analysis looked at the customers' status as accredited or unaccredited, net worth, gender, age, location, real estate investing experience, occupation, and which radio programs got those investors to LREA.[180] LREA's tracking system for the "ideal customer" focused on the amount of money the workshop attendees invested in private placements.[181]

LREA also created monthly "pipeline" spreadsheets.[182] These documents projected how many workshop attendees would meet the issuer, potential dollar amount of unregistered securities they would purchase, and an anticipated "close ratio."[183] These spreadsheets, which also focused on sales of securities as opposed to education, were reviewed by LREA and the affiliated issuers.[184]

H. William H. Murphy & Co.'s Supervisory System in Connection with the Sales of Unregistered Securities

Murphy, as WHM's CCO, was responsible for establishing and maintaining the firm's supervisory system, including the WSPs. The WSPs designated Murphy as the individual responsible for accepting customer accounts and supervising all associated persons, advertising, and private placement activities.[185] Although Murphy assigned Hutton to supervise the LREA OSJ branch, Murphy remained ultimately responsible for

[176] Tr. 86-87, 1106. Price also testified that "we were spending so much money on advertising, we had to understand where these leads were coming from. If you did not get them into that workshop, then you're throwing money away because you're never going to build the brand." Tr. 630-31.

[177] CX-124; Tr. 406-08.

[178] Tr. 418-19.

[179] Tr. 415-16.

[180] Tr. 417.

[181] CX-108A, at sheets 1-2; CX-128A, at sheets R1-R3.

[182] CX-138; CX-139; Tr. 376.

[183] Tr. 378-80.

[184] Tr. 375; *see, e.g.*, CX-138.

[185] JX-1 at 12, 13, 70, 137.

the supervision of the LREA OSJ.[186] Murphy was also responsible for monitoring the radio shows and pre-approving the scripts for the workshops that Price conducted.[187]

Hutton supervised the LREA OSJ branch from March 15, 2011, until August 24, 2012. During that time, Hutton had less than one year of experience supervising private placements, the only product LREA offered, and Price had no prior experience working as a registered representative before joining WHM.[188] Despite Hutton's inexperience supervising the sale of private placements, Murphy only provided verbal instructions to Hutton with respect to compliance with Section 5 of the Securities Act.[189] Murphy advised Hutton to make sure that the radio shows and workshops did not mention the offerings, securities, or the issuers.[190] WHM and Murphy established no WSPs setting forth red flags that Hutton should be aware of when supervising radio shows, workshops, or private placement sales.[191] In fact, the WSPs did not address WHM's relationship with LREA or any of the issuers.[192]

As the registered principal for the LREA OSJ, Hutton supervised Price in her capacity as a registered representative and was responsible for initialing, reviewing, and approving her securities transactions.[193] Hutton conducted suitability reviews for the new customers who completed a WHM new account form after meeting with Price.[194] When conducting his suitability reviews, he would send the information about each prospective customer to WHM's law firm for an additional review by a non-lawyer at the law firm who served as WHM's financial and operations professional and provided compliance support.[195] After this additional review, Murphy approved the new account form.

Murphy delegated to Hutton the responsibility for monitoring the one-on-one meetings Price had with prospective WHM customers.[196] However, Hutton did not attend Price's one-on-one meetings with prospective customers, and Murphy never instructed

[186] Tr. 729, 1283-84; JX-64.

[187] RX-194, at 21, 48; Tr. 1210-11, 1223-24, 1227-28, 1262-63.

[188] Tr. 44, 45, 61, 69, 709-10, 1233-34.

[189] Tr. 1223-25.

[190] Tr. 1225.

[191] Tr. 1222-26, 1232-33, 1235-36, 1241, 1245, 1247.

[192] Tr. 1232, 1234, 1235, 1289-92.

[193] Tr. 69, 83, 503, 728; CX-21, at 2.

[194] Tr. 70, 73, 83, 222, 503-04; CX-7, at 7.

[195] Tr. 997, 1209-12, 1242, 1724-26. Although he conducted a secondary review, the financial and operations professional was not delegated any authority to approve new accounts or any advertising material at WHM. Tr. 1211-12.

[196] Tr. 1260.

him on how to monitor the one-on-one meetings.[197] WHM and Murphy did not establish any WSPs for supervision of the one-on-one meetings.[198]

At the time Price conducted her one-on-one meetings with prospective WHM customers who were interested in the private placement offerings, the only offering materials she read were the materials for the GEF offering. She had read these materials because she personally invested in that offering.[199] Although Price conducted the initial meetings to determine if the prospective WHM customers were qualified to invest in the offerings, neither Murphy nor Hutton required her to read the PPMs for the offerings.[200] In fact, Murphy was unaware that Price was not reviewing the offering materials for the securities she was selling to WHM customers.[201] When questioned about this at the hearing, Murphy testified that he was not concerned that Price failed to read the offering materials for the private placements she was selling.[202]

WHM, through Murphy, also failed to implement reasonable procedures and WSPs to ensure that they did not participate in selling unregistered non-exempt securities.[203] WHM failed to establish and maintain procedures (1) prohibiting customers obtained from radio shows and workshops from purchasing unregistered private placements that were available for sale before the customer established a relationship with WHM;[204] and (2) creating a review process wherein supervisors, such as Hutton, would verify compliance with the pre-existing, substantive relationship requirement of SEC Rule 506.[205] In addition, although Murphy and the WHM registered representatives testified that they employed a cooling-off period, WHM had no written procedures

[197] Tr. 1102, 1105, 1260.

[198] Tr. 1261.

[199] Tr. 98-99, 189, 307-08.

[200] Tr. 307. Referring to the PPM for the MFREF2 offering, Price testified, "I don't believe I looked at this document." Tr. 308.

[201] Tr. 1348.

[202] Tr. 1347-48.

[203] Respondents also failed to include the LREA OSJ in WHM's supervisory control procedures. JX-2; Tr. 1289, 1292.

[204] Tr. 1065-66, 1222-26, 1235-36, 1241, 1245, 1247.

[205] Tr. 1064-66, 1241, 1245, 1247. Neither Murphy nor Hutton were able to point to procedures: (1) prohibiting customers obtained from radio shows and workshops from purchasing unregistered private placements that were available for sale before the customer established a relationship with WHM; or, (2) describing a review process wherein supervisors would verify that new customers were not being sold unregistered securities whose offerings had commenced before establishing a substantive relationship with WHM. Tr. 1061-62, 1064-66, 1245-47. The only procedure Hutton could identify was a generic section in the WSPs stating that WHM would hold meetings to "discuss thoroughly the nature of any security or underwriting or offering in which the Company participates." Tr. 740-44, 943-45, 1054-65; JX-1, at 151.

requiring a cooling-off period or identifying the date to be used by the firm to calculate a cooling-off period.[206] Murphy did not believe that such procedures were necessary.[207]

No one at WHM monitored the security purchases to make sure that new customers did not purchase securities in any offerings that were open before the customer became a WHM customer. Murphy admitted that he did not address and was not concerned about whether WHM's new customers from the radio shows and workshops purchased securities in private placements that were open for sale before WHM established a substantive relationship with the new customer.[208] Similarly, Hutton admitted that he did not take any steps to ensure that WHM's customers were not offered unregistered securities in offerings that were open for sale before WHM established a substantive relationship with a new customer.[209] Although Hutton and Price received commissions on the sales, Hutton testified that, from his perspective, the new WHM customers became clients of the issuers.[210]

WHM reviewed all of LREA's emails,[211] monitored LREA's customer relationships through LREA's CRM system,[212] and approved all of LREA's communications with the public.[213] That said, WHM, through Murphy, ignored red flags concerning its participation in the sale of unregistered securities in violation of Section 5. First, the issuers' and LREA's only revenue source flowed from sales of unregistered securities from the private placements.[214] Second, Murphy and the LREA employees expected and depended on the radio shows and workshops to generate new customers to whom WHM would sell the unregistered securities.[215] When Respondents entered into the OSJ Agreement with LREA and became the exclusive managing placement agent and underwriter for the private offerings, Murphy refused to recommend the securities to WHM's existing customers.[216] Accordingly, the only customers who would be purchasing the unregistered securities from WHM would be new customers obtained as a

[206] Tr. 1247-48, 1254-55; RX-194, at 78-79; *see* JX-1.

[207] Tr. 1247-48.

[208] RX-194, at 52-53.

[209] Tr. 1065-66.

[210] Tr. 1065-66.

[211] Tr. 933, 1029, 1098, 1124.

[212] Tr. 804, 1275, 1316.

[213] Tr. 639-40. WHM approved LREA's business cards and even t-shirts for a fundraising event. Tr. 609; RX-116.

[214] JX-7, at 21, 96; JX-32, at 19, 108; CX-84 at 19, 140; RX-194, at 42-44.

[215] Tr. 767, 777-78. These new WHM customers also generated commissions for WHM registered representatives, who were also LREA employees.

[216] Tr. 1155, 1314.

result of the radio shows and workshops.[217] Finally, Murphy knew that the listeners perceived the radio shows as solicitations to sell securities.[218] Indeed, Murphy received over 50 calls from listeners of the radio shows asking about his entry into selling real estate-related securities.[219] Despite these red flags, WHM participated in selling unregistered securities and made no reasonable effort to determine if its conduct was in compliance with the Securities Act's prohibition on general solicitation.

III. Conclusions of Law

The Panel found Respondents liable for the causes of action in the Complaint. The Panel found that (1) WHM violated FINRA Rule 2010 by selling unregistered, non-exempt securities in violation of Section 5 of the Securities Act; and (2) WHM and Murphy violated NASD Rule 3010 and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including WSPs, reasonably designed to ensure compliance with Section 5 of the Securities Act. Addressed below are each violation and Respondents' defenses.

A. William H. Murphy & Co. Violated FINRA Rule 2010 by Selling Unregistered, Non-Exempt Securities, in Violation of Section 5 of the Securities Act

The first cause of action alleges that WHM violated FINRA Rule 2010 by engaging in unregistered sales of over $1 million of securities to 23 customers, in violation of Section 5 of the Securities Act. Below is a discussion of how (1) Enforcement satisfied its burden of establishing that WHM sold unregistered securities, and (2) WHM failed to meet its burden of demonstrating the securities were exempt from the registration requirements.

1. Enforcement Met Its Burden of Demonstrating that WHM Engaged in the Sale of Unregistered Securities

"The registration requirements are the heart of the [Securities] Act."[220] Their purpose is to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions."[221] To effect this purpose, Section 5 of the

[217] Tr. 1155, 1314.

[218] Tr. 1229-30.

[219] Tr. 1229-30; RX-194, at 21.

[220] *Pinter v. Dahl*, 486 U.S. 622, 638 (1988).

[221] *Midas Securities, LLC*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *26 (Jan. 20, 2012) (citing *Ralston Purina*, 346 U.S. 119, 124 (1953) and *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963)) "Registration is the central mechanism the framers of the securities acts chose for the protection of investors." *Woolf v. S.D. Cohn & Co.*, 515 F.2d 591, 605 & n.6 (5th Cir. 1975) (Wisdom, J.), *vacated and remanded on other grounds*, 426 U.S. 944 (1976).

Securities Act prohibits the offer and sale of any securities unless a registration statement is in effect or an exemption is available.[222]

To establish a violation of Section 5(c), Enforcement had the burden of showing that "(1) no registration statement was in effect or filed as to the securities; (2) a person, directly or indirectly, sold or offered to sell the securities; and (3) the sale or offer to sell was made through the use of interstate facilities or mails."[223] Section 5 imposes strict liability on those who offer to sell an unregistered security, irrespective of any degree of fault.[224] Scienter is not an element of a Section 5 violation.[225]

FINRA Rule 2010 requires members and associated persons, in the conduct of their business, to "observe high standards of commercial honor and just and equitable principles of trade." It is well settled that acting in contravention of Section 5 constitutes a violation of Rule 2010.[226]

Enforcement established that WHM violated Section 5 of the Securities Act. First, there were no registration statements in effect or filed for the securities at issue. Each PPM specifically stated that the LLC interests were not registered. In addition, Respondents admitted that the three offerings were unregistered securities purportedly sold pursuant to an exemption.[227]

Second, WHM sold securities in the three unregistered offerings. WHM was a "necessary participant in a sale of unregistered stock."[228] Brokering the sale of securities constitutes such participation and exposes the broker to liability under Section 5.[229] WHM was the sole placement agent, underwriter, and broker for the unregistered offerings at issue. WHM also received a commission for sales to its customers of the unregistered securities.

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[222] *See* 15 U.S.C. § 77e; s*ee also Midas Securities*, 2012 SEC LEXIS 199, at *25-26.

[223] *Midas Securities*, 2012 SEC LEXIS 199, at *27 (citing *SEC v. Cavanagh*, 445 F.3d 105, 111 n.13 (2d Cir. 2006)); *SEC v. Calvo*, 378 F.3d 1211, 1214-15 (11th Cir. 2004).

[224] *See SEC v. Stratocomm Corp.*, 2 F. Supp. 3d 240, 263-64 (N.D.N.Y. 2014).

[225] *See Midas Securities*, 2012 SEC LEXIS 199, at *27 (citing *Calvo*, 378 F.3d at 1215; *SEC v. Universal Major Indus. Corp*., 546 F.2d 1044, 1047 (2d Cir. 1976)).

[226] *See Midas Securities*, 2012 SEC LEXIS 199, at *46 n.63 (citing *Sorrell v. SEC*, 679 F.2d 1323, 1326 (9th Cir. 1982)).

[227] Ans. ¶ 78; JX-75.

[228] *SEC v. Cavanagh*, 1 F. Supp. 2d 337, 372 (S.D.N.Y.) (granting injunction), *aff'd*, 155 F.3d 129 (2d Cir. 1998) (citing *SEC v. Softpoint, Inc*., 958 F. Supp. 846, 859-60 (S.D.N.Y. 1997), *aff'd*, 159 F.3d 1348 (2d Cir. 1998)).

[229] *Quinn & Co. v. SEC*, 452 F.2d 943, 946-47 (10th Cir. 1971); *Dep't of Enforcement v. Morgan Keegan & Co.*, No. CAF040073, 2006 NASD Discip. LEXIS 24 (OHO July 21, 2006); c*f. Dep't of Market Regulation v. Proudian*, No. CMS040165, 2008 FINRA Discip. LEXIS 21 (NAC Aug. 7, 2008) (distinguishing between liability of broker having direct contact with customers from that of person who merely executes trades).

Lastly, the three offerings were made through the use of interstate facilities in several ways. WHM used radio shows and radio commercials to attract new customers. The radio shows and commercials were broadcast over the airways. The radio shows were also placed on LREA's website as podcasts and were available for listening over the Internet, and sent to potential investors via email as podcasts links. WHM and LREA communicated with customers and investors in connection with selling unregistered securities to them via emails and the telephone. And, customer funds were wired to banking institutions, and investors faxed information to the issuers.[230]

2. WHM Failed to Show that the Securities Were Exempt from Registration

Enforcement met its burden of showing that Respondents acted in contravention of Section 5; therefore, the burden shifted to WHM to prove that an exemption from the registration requirement existed.[231] In the GEF, MFREF2, and MFREF3 offerings, the issuers claimed an exemption from registration pursuant to Rule 506 of Regulation D. In addition, WHM argues that the securities are exempt from registration pursuant to Section 4(a)(2) of the Securities Act.

The section below provides a discussion of the applicable exemptions and each of WHM's arguments in support of its position that the securities were exempt from registration.

a. Overview of Applicable Exemptions

Two common private offering exemptions are Section 4(a)(2) of the Securities Act and Rule 506(b) of Regulation D. Section 4(a)(2) of the Securities Act provides a statutory exemption for "transactions by an issuer not involving any public offering." Rule 506(b) of Regulation D provides a "safe harbor" for an issuer engaged in a non-public offering to persons who may or may not be "accredited." WHM asserts that both are applicable here.

Both Section 4(a)(2) and Rule 506(b) have qualification requirements for the offerees. In *SEC v. Ralston Purina*, the Supreme Court addressed the Section 4(a)(2)

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[230] *See Dep't of Enforcement v. Ahmed*, No. 2012034211301, 2015 FINRA Discip. 45, at *56 (NAC Sept. 25, 2015) (noting that the jurisdictional element is satisfied because respondents communicated with investors via the telephone and email); *see also Softpoint, Inc.*, 958 F. Supp. 846, 865 (determining that the jurisdictional requirements of the federal antifraud provisions are interpreted broadly and are satisfied by intrastate telephone calls or the use of the U.S. mail); *cf. United States v. Barlow*, 568 F.3d 215, 220 (5th Cir. 2009) (explaining that 18 U.S.C. § 2422(b) requires the use of "any facility or means of interstate or foreign commerce," and "it is beyond debate that the Internet and email are facilities or means of interstate commerce").

[231] *See ACAP Fin., Inc.*, Exchange Act Release No. 70046, 2013 SEC LEXIS 2156, at *29 (July 26, 2013), *aff'd*, 2015 U.S. App. LEXIS 5384 (10th Cir. Apr. 3, 2015); *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 SEC LEXIS 56, at *24 (Jan. 6, 2012) ("Exemptions from the registration requirements are affirmative defenses that must be established by the person claiming the exemption.").

exemption and focused on all offerees, not just the ultimate purchasers of securities. [232] The Court noted that an offering to persons who are shown to be able to "fend for themselves" is a transaction not involving any public offering. In determining whether a person is capable of fending for himself, the Court appeared to be concerned with whether all offerees (1) had access to the kind of information which registration would disclose and (2) were financially sophisticated. In *Lively v. Hirschfeld*, the Court of Appeals limited the Section 4(a)(2) private offering exemption to include "only persons of exceptional business experience, and [those in] a position where they have regular access to all the information and records which would show the potential for the corporation."[233] In *SEC v. Continental Tobacco*, the Court of Appeals required the issuer to prove that each offeree had a relationship with the issuer giving access to the kind of information that registration would have disclosed.[234] For an issuer to utilize the Rule 506(b) exemption, the issuer needs to make sure that the offering is made to accredited investors and not more than 35 sophisticated yet unaccredited investors.

To claim either the Section 4(a)(2) or the Rule 506(b) exemption, the issuer, or anyone acting on behalf of the issuer, must comply with the general solicitation prohibition in SEC Rule 502(c). During the Relevant Period, Rule 502(c) provided that

> neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to, the following: (1) any advertisement, article, notice or other communication published in any newsletter, magazine or similar media or broadcast over television or radio; and (2) any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.[235]

Enforcement and Respondents agree that any exemption that may apply to the securities at issue requires compliance with a general solicitation prohibition in SEC Rule 502(c).[236] Accordingly, this Decision will focus on whether WHM engaged in general solicitation activities.

b. The Radio Shows and Workshops Constituted an Offer to Sell Securities

To determine whether WHM "offer[ed] … securities by any form of general solicitation or general advertising," it is first necessary to determine if WHM offered securities. Section 2(3) of the Securities Act states that an "'offer' shall include every

[232] *SEC v. Ralston Purina*, 346 U.S. 119 (1953).

[233] *Lively v. Hirschfeld*, 440 F.2d 631, 633 (10th Cir. 1971).

[234] *SEC v. Continental Tobacco*, 463 F.2d 137 (5th Cir. 1972).

[235] 17 C.F.R. § 230.502.

[236] JX-75.

attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." These terms under the Securities Act and rules promulgated thereunder, including SEC Rule 502, have been construed broadly.[237] "If the content indicates that the communication is designed to procure orders for a security, arouse interest in a security, or condition the public mind, then the communication is an offer to sell securities."[238] Communications with the general public designed to awaken an interest in potential investors in an issuer's securities constitutes an "offer" for purposes of SEC Rule 502(c) even if the communication does not mention the issuer or any particular security.[239]

In *Gearhart & Otis, Inc*., the SEC provided guidance about what constitutes an offer. In that case, the issuer engaged in a private placement involving lithium mines and distributed news articles that touted lithium, but did not expressly offer any securities or reference the issuer.[240] The issuer argued that these news articles did not constitute an offer to sell securities. However, the SEC disagreed, holding that:

> the distribution of the literature concerning lithium was the first step in a campaign to sell National Lithium stock and as such constituted an offer to sell such stock … [even though] the literature in question made no specific reference to National Lithium or to the prospective offering of its securities, it was designed to awaken an interest in lithium securities which could shortly afterwards be focused on the National Lithium stock.[241]

The LREA-affiliated issuers were organized to acquire, rent, and manage apartments. The issuers engaged in private placements and employed WHM representatives to host radio shows and conduct workshops that touted (1) the benefits of investing in apartments; (2) adding apartments to investment portfolios; and (3) how passively investing in apartments through private placements could be a lucrative investment providing 55% annual returns and infinite net operating income. Even though the radio shows and workshops did not specifically mention an issuer or private

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[237] *Dist. Bus. Conduct Comm. v. Prendergast*, No. C3A960033, 1999 NASD Discip. LEXIS 19, at *54 (NAC July 8, 1999), *aff'd*, *Brian Prendergast*, Exchange Act Release No. 44632, 2001 SEC LEXIS 1533 (Aug. 1, 2001).

[238] *Blue Flame Energy Corp. v. Ohio Dep't. of Commerce, Div. of Sec*., 871 N.E.2d 1227, 1246 (Ohio App. 10th Dist. 2006) (citing *Offering of Interests in Thoroughbred Racing Stable*, SEC No-Action Letter, 1976 SEC No-Act. LEXIS 5 (Jan. 5, 1976) and *Gerald F. Gerstenfeld*, SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2790 (Dec. 3, 1985)).

[239] *Gearhart & Otis, Inc*., 42 S.E.C. 1, 24-26 (1964), *aff'd*, 348 F.2d 798 (D.C. Cir. 1965); *see also Blue Flame*, 871 N.E.2d at 1246 (noting that a communication can constitute an offer "even if [it] does not directly refer to the securities the issuer is currently offering for sale …") (citing *Alma Sec. Corp*., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2647 (Aug. 2, 1982)).

[240] *Gearhart & Otis, Inc*., 42 S.E.C. at 24-26.

[241] *Id.* at 26.

placement offering by name, they were designed to awaken an interest in passively investing in apartments that was focused on the LREA-affiliated issuers' unregistered securities.

In *Prendergast*, the SEC looked at the purpose of the communication with the public to determine if the communication constituted an offer. *Prendergast* involved a registered representative of a broker-dealer who advertised a seminar he was giving on hedge funds.[242] The newspaper advertisement read, in part: "Today's Hottest Investment/Hedge Funds/WHAT THEY ARE/HOW TO INVEST."[243] Although the registered representative testified that the information given in the seminar was "generic" in nature, he had sent a letter to investors (prior to the seminar) stating that the seminar was intended to attract new investors to the fund. The SEC held that the purpose of the advertisement led to the conclusion that the advertisement and the seminar were general solicitations to offer or sell securities.[244]

LREA's stated purpose was to use radio shows and workshops to obtain investors to buy securities in its affiliated issuers' private placements. The issuers created a model that placed WHM in the "chain of general solicitation." The model differed from other real estate investment organizations that utilized radio programs and seminars in that the LREA-affiliated issuers had WHM (a registered broker-dealer) for the purpose of selling unregistered securities to potential investors once they expressed an interest in passively investing in apartments. Although none of the radio shows or workshops expressly mentioned any specific securities or referenced the issuers by name, the radio shows and workshops were intended to be the first step in a campaign, which WHM characterized as the "customer's journey" and "chain of general solicitation," and, therefore, constituted an offer to sell the LREA-affiliated issuers' unregistered securities. The obvious purpose of the radio shows and workshops is underscored by the fact that Murphy expected 5% to 10% of the workshop attendees would purchase private placements from WHM, and negotiated fees and commissions based on his projection of how many new customers generated from the radio shows and workshops would purchase LLC interests in the issuers' unregistered offerings.

LREA's internal documents also demonstrated that the radio shows and workshops were intended to solicit investors. LREA created a composite of its "ideal client." It tracked which radio station program successfully attracted listeners to workshops. Success was determined by the total amount invested in unregistered securities by the listeners that became WHM customers. Price testified that the radio shows were so expensive that LREA had to track the source of the "leads," otherwise, they were "throwing money away." LREA also created a monthly "pipeline" spreadsheet

[242] *Brian Prendergast*, 2001 SEC LEXIS 2767.

[243] *Id*. at *15.

[244] *Id*. at *32-34.

to project how many workshop attendees would likely invest in affiliated issuers' unregistered securities and the anticipated amount of those investments. The information was important to LREA and its affiliated issuers because investor funds were the only source of revenues for all of them.

Moreover, the issuers, LREA, and WHM all shared office space, and the issuers' employees taught workshops, hosted radio shows, and recorded videos that were placed on LREA's website. Some of these issuer employees who also worked for LREA were the same ones closing the sales of unregistered securities on behalf of the issuers. Providing access to the issuers' employees at every stage of the "chain of general solicitation" indicates that the purpose of the radio shows and workshops was to solicit investors.

The Panel finds that the purpose of the radio shows and workshops was to awaken an interest in investing and attract new investors to the affiliated issuers' unregistered securities. Based on *Prendergast* and *Gearhart*, the radio shows and workshops constituted offers to sell unregistered securities of GEF, MFREF2, and MFREF3. The radio shows and workshops were successful and led to new WHM customers who invested in the GEF, MFREF2, and MFREF3 offerings.

c. WHM Offered the Securities by General Solicitation

The test for determining what constitutes a general solicitation depends on the existence and substance of a relationship between the issuer and those being solicited before the offering commences or is contemplated.[245] The SEC has explained that an issuer is only permitted to solicit interest in private placements from persons who have a pre-existing *and* substantive relationship with them before the offering has commenced or is contemplated.[246] The SEC permits an issuer to engage broker-dealers to sell private placements to their customers; however, to avoid engaging in a general solicitation when the issuer seeks to sell unregistered securities to a broker-dealer's customers, the broker-dealer's relationship with the customer must be established *prior* to the time the broker-

[245] *Prendergast*, 1999 NASD Discip. LEXIS 19, at *57 (citing *Kenman Corp.*, Exchange Act Release No. 21962, 1985 SEC LEXIS 1717 (Apr. 19, 1985)).

[246] *See, e.g.*, *Woodtrails-Seattle, Ltd.*, 1982 SEC No-Act. LEXIS 3288 (July 8, 1982); *E.F. Hutton & Co.*, 1985 SEC No-Act. LEXIS 2917 (Dec. 3, 1985); *Bateman Eichler, Hill Richards, Inc.*, 1985 SEC No-Act. LEXIS 2918 (Dec. 3, 1985).

dealer begins participating in the offering.[247]

The issuers for the GEF, MFREF2, and MFREF3 offerings engaged WHM as the exclusive managing placement agent and underwriter. WHM began participating in each offering on the first day the offerings commenced. In order for the WHM to avoid engaging in any general solicitation, WHM must show that the radio broadcasts and workshops were limited to listeners that either WHM or the issuers already had a substantive relationship with before the offerings commenced.[248]

The SEC has stated that "[s]ubstantive relationships may be established with persons who have provided satisfactory responses to questionnaires that provide … sufficient information to evaluate the prospective offerees' sophistication and financial circumstances."[249] Although WHM claims that it established a substantive relationship with its customers on the date LREA received the Contact Information Forms from individuals that attended a workshop, the forms did not contain any information about the attendees' sophistication and financial situation. Accordingly, LREA's Contact Information Forms did not provide sufficient information upon which WHM could establish a substantive relationship.[250]

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[247] Respondents argue that pre-existing means that "the broker-dealer must establish the relationship before extending an offer to a prospective offeree." Respondents' Post Hrg Br. at 39. However, Respondents misstate the SEC's guidance. *See* SEC's Compliance and Disclosure Interpretations ("C&DI") at Question 256.29, https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm (stating that "[a] 'pre-existing' relationship is one that the issuer has formed with an offeree prior to the commencement of the securities offering or, alternatively, that was established through either a registered broker-dealer or investment adviser prior to the registered broker-dealer or investment adviser's participation in the offering."); *see also Bateman Eichler, Hill Richards, Inc*., 1985 SEC No-Act. LEXIS 2918, at *1 (stating procedures implemented to ensure "persons solicited are not offered securities that were offered or contemplated for offering at time of solicitation," then contacting prospective offerees does not constitute an offer to sell securities); *E.F. Hutton & Co*., 1985 SEC No-Act. LEXIS 2917, at *2 (stating if relationship established prior to time E.F. Hutton began participating in the Regulation D offering, an offer could be made to the person with whom the relationship was established without violating Rule 502(c)); *see also Prendergast*, 1999 NASD Discip. LEXIS 19, at *53 (agreeing with DBCC's holding that "because the Regulation D private offering was ongoing at the time, the advertisement constituted a general solicitation of investments in the private placement, which is not permitted under SEC Rule 502(c), and therefore violated Conduct Rule 2210(e)").

[248] *See, e.g., Woodtrails-Seattle, Ltd.*, 1982 SEC No-Act. LEXIS 3288 (July 8, 1982); *E.F. Hutton*, 1985 SEC No-Act. LEXIS 2917; *Bateman Eichler*, 1985 SEC No-Act. LEXIS 2918; *see supra* footnote 247.

[249] *E.F. Hutton*, 1985 SEC No-Act. LEXIS 2917, at *1-2.

[250] Respondents' assertion that the Contact Information Forms created a pre-existing, substantive relationship is also inconsistent with their positon that the LREA employees (who were also WHM registered representatives) wore two distinct hats, an LREA hat and a WHM hat. If the Panel were to accept Respondents' argument that the LREA employees were only wearing their LREA hat, which the Panel does not accept, then WHM would be claiming that it established a substantive relationship with prospective customers who had not yet even met a WHM registered representative or completed a WHM new account form.

WHM's new account form contained sufficient information upon which WHM could establish a substantive relationship with its customers. The new account forms elicited information about the prospective investor's sophistication and financial situation. However, none of the new account forms was completed before WHM began participating in the offerings. WHM did not establish a substantive relationship with the 23 customers at issue in this matter before the offerings in which they purchased securities had commenced.

d. The Investment Company Act of 1940 Does Not Apply to These Offerings

Respondents' argue that the GEF, MFREF2, or MFREF3 issuers had an exemption from the Investment Company Act of 1940 ("Investment Company Act"), which permitted WHM to sell securities in an offering that was "live" at the time WHM established its substantive, pre-existing relationship with the customers at issue. In support of its position, WHM cites to *Lamp Technologies*, an SEC no-action letter.[251]

In *Lamp Technologies*, the issuers were "funds excluded from regulation as investment companies pursuant to Sections 3(c)(1) or 3(c)(7) of the Investment Company Act and privately offered pursuant to Regulation D under the Securities Act."[252] Both sections 3(c)(1) and (7) of the Investment Company Act contain, among other things, a prohibition from publicly offering an issuer's securities.[253] One of the assurances sought in *Lamp Technologies* was that the issuers would not lose the 3(c)(1) or (7) exemption based on the proposed solicitation activity described in the no-action letter.[254] The SEC opined that if the issuers followed the guidance in the no-action letter, then the issuers would not violate the safe harbor provided by either section 3(c)(1) or (7) of the Investment Company Act and would not need to register the issuer fund with the SEC.[255]

The GEF, MFREF2, or MFREF3 issuers were private limited liability companies organized under Texas state law with the express intention to purchase and rehabilitate apartment complexes, improve their occupancy rates, and re-sell them. They were not

[251] *Lamp Technologies, Inc.*, 1997 SEC No-Act. LEXIS 638 (May 29, 1997).

[252] *Id*. at *2.

[253] *Id*. at *3 n.1.

[254] *Id*. at *1.

[255] *Id*. at *9-10.

"investment companies" as that term is defined in the Investment Company Act.[256] Accordingly, the Investment Company Act and its exemptions from registration do not apply to this disciplinary action.[257]

e. WHM's Cooling-Off Period Did Not Break the Chain of Solicitation

Respondents contend any 30-day delay between a workshop and signing a subscription agreement "breaks the chain of solicitation." Respondents argued that the cooling-off period ran from the date of the general solicitation, which they assert was the workshop date or the radio show. However, there is no authority to support their position. All of the relevant guidance prohibits selling unregistered securities to investors that were obtained through any form of general solicitation when the issuer or anyone affiliated with the issuer establishes a substantive relationship with the new investor after the offering commences.[258] Even the SEC Compliance and Disclosure Interpretations ("C&DI") that were updated in August 2015 still require a substantive pre-existing relationship before selling unregistered securities in open offerings to new investors obtained through general solicitation.[259] The new C&DIs also prohibit a broker-dealer from selling unregistered securities in open offerings to new customers obtained through general solicitation after the broker-dealer began participating in the offering.[260]

In C&DI 256.30, the SEC cited *Lamp Technologies* and stated that the staff provided a limited accommodation for offerings by private funds that rely on the exclusions from the definition of "investment company" set forth in Sections 3(c)(1) and 3(c)(7) of the Investment Company Act because private fund offerings are made on a

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[256] *See* Section 3(a)(1) of the Investment Company Act, 15 U.S.C. § 80a-3(a)(1) (defining "investment company" as "any issuer which (A) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities; (B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or (C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets … on an unconsolidated basis.").

[257] Respondents also argue that SEC Rule 135a supports their position that "when a public communication does not refer specifically by name to a security or a particular investment company, there is no offer to sell securities." Respondents' Post Hrg Br. at 10. Rule 135a, however, was promulgated under the Securities Act to "permit generic advertising of *investment company securities*, even by dealers who underwrite particular funds or sponsors of no-load funds." Securities Act Release No. 5248, 1972 SEC LEXIS 70, at *8-9 (May 9, 1972) (emphasis added). As discussed above, the GEF, MFREF2, and MFREF3 issuers were not investment companies; and therefore, their unregistered LLC interests were not "investment company securities." Accordingly, the provisions of Rule 135a do not apply.

[258] *See supra* footnotes 247 and 248.

[259] C&DI at Question 256.29, https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.

[260] *Id*.

semi-continuous basis.[261] *Lamp Technologies* is the only no-action letter that permitted investments in hedge funds after the funds were open offerings. As stated above, the GEF, MFREF2, and MFREF3 issuers were not investment companies under the Investment Company Act who continually raised money on a semi-annual or annual basis. Instead, the issuers in this matter were private LLCs organized under Texas state law that intended to purchase apartment complexes for real estate flips.

f. SEC Rule 508 Does Not Allow the Rule 506, Regulation D Exemption to Remain Intact

Respondents argue that WHM made a good faith attempt to comply with the requirements of the Rule 506, Regulation D exemption, and the exemption should remain intact pursuant to SEC Rule 508. Rule 508 allows a Regulation D exemption to remain intact if the person relying on the exemption shows:

> (1) The failure to comply did not pertain to a term, condition or requirement directly intended to protect that particular individual or entity; and (2) the failure to comply was insignificant with respect to the offering as a whole, *provided that any failure to comply with paragraph (c) of § 230.502, paragraph (b)(2) of § 230.504, paragraphs (b)(2)(i) and (ii) of § 230.505 and paragraph (b)(2)(i) of § 230.506 shall be deemed to be significant to the offering as a whole*; and (3) a good faith and reasonable attempt was made to comply with all applicable terms, conditions and requirement of § 230.504, § 230.505 or § 230.506."[262]

Rule 508 states that it applies to "insignificant deviations from a term, condition or requirement of Regulation D." As reflected above, any failure to comply with Rule 502(c) "shall be deemed to be significant to the offering as a whole." An issuer cannot rely on the "insignificant deviation" relief in Rule 508 of Regulation D for violations of Rule 502(c).[263] Accordingly, the general solicitation in this case renders Rule 508 inapplicable.

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[261] *Id*. at Question 256.30.

[262] 17 C.F.R. § 230.508 (emphasis added). When Respondents made this argument in their post-hearing brief, they omitted the relevant portion of SEC Rule 508. Respondents' Post Hrg Br. at 31. Specifically, they omitted the critical language in italics above pertaining to Rule 502 (c). They did this knowing that the general solicitation prohibition of Rule 502(c) was at issue in this proceeding and had entered into a joint stipulation with Enforcement on that very subject. The Panel finds that Respondents' omission of the Rule 502(c) language when quoting Rule 508 was a deliberate attempt to mislead the Panel.

[263] 17 C.F.R. § 230.508(a)(2); *see* Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 33-9415, 2013 SEC LEXIS 2004, at *19 n.41 (July 10, 2013).

g. The Securities Were Not Exempt Pursuant to Section 4(a)(2) or SEC Rule 506

Both Section 4(a)(2) and Rule 506(b) prohibit the use of general solicitation or general advertising.[264] Using general solicitation "is inconsistent with a claim that the offering does not involve a public offering even though ultimately there may only be a few knowledgeable purchasers."[265] Here, persons affiliated with the issuers used general solicitations (radio shows and workshops) to sell the unregistered securities. The Panel finds that WHM's claimed Section 4(a)(2) and Rule 506(b) exemptions fail.

h. The JOBS Act Is Not Applicable

Respondents also assert that the JOBS Act renders their violations moot. The JOBS Act was enacted on April 5, 2012. It directed the SEC to revise its rules to provide that the prohibition against general solicitation and general advertising contained in Rule 502(c) of Regulation D not apply to offers and sales of securities made pursuant to Rule 506, provided that all purchasers of the securities are accredited investors. On July 10, 2013, the SEC adopted a new rule, Rule 506(c), which became effective on September 23, 2013. SEC Rule 506(c) provided a "safe harbor" for an issuer engaged in general advertising to accredited investors only.

The enactment of Rule 506(c) as a result of the JOBS Act does not render WHM's violations moot for two reasons. First, Rule 506(c) was not enacted retroactively.[266] Second, WHM participated in the sales of unregistered securities to unaccredited investors, which is not permitted under the Rule 506(c). Thus, even if the JOBS Act were applied retroactively, it would not make WHM's conduct permissible.

3. Conclusion

The Panel finds that Enforcement established that WHM engaged in unregistered sales of more than $1 million of securities to 23 customers, in violation of Section 5 of the Securities Act. WHM failed to prove that an exception to the registration requirement existed. The unregistered securities were sold through general solicitation and as such the

[264] Respondents acknowledge that Section 4(a)(2) prohibits general solicitation by stipulating that "all applicable exemptions require compliance with the general solicitation prohibition found in SEC Rule 502(c)." JX-75. The stipulation is also consistent with a recent SEC pronouncement regarding general solicitations precluding the availability of the registration exemption under Section 4(a)(2). *See* SEC's C&DI at Question 260.13 (Aug. 6, 2015), https://www.sec.gov/divisions/corpfin/guidance/securities actrules-interps.htm ("The use of general solicitation continues to be incompatible with a claim of exemption under Section 4(a)(2).").

[265] Nonpublic Offering Exemption, Securities Act Release No. 4552, 1962 SEC LEXIS 166, at *3 (Nov. 6, 1962); *see also* Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 33-9415, 2013 SEC LEXIS 2004, at *19-20.

[266] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 33-9415, 2013 SEC LEXIS 2004, at *32.

exemptions that WHM claimed were not valid. The Panel concludes that WHM violated FINRA Rule 2010 by selling unregistered, non-exempt securities in violation of Section 5 of the Securities Act.[267]

B. William H. Murphy & Co. and William H. Murphy Violated NASD 3010 and FINRA Rule 2010 by Failing to Reasonably Supervise Its Sales of Unregistered Securities

The second cause of action alleges that WHM and Murphy violated NASD Rule 3010 and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including WSPs, reasonably designed to ensure compliance with Section 5 of the Securities Act.

NASD Rule 3010 (a) requires firms to "establish and maintain a system to supervise activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules." Under NASD Rule 3010(b), these systems must be documented in the firm's WSPs. The procedures also must be tailored to the business lines in which the firm engages.[268] In addition, the procedures must set out mechanisms for ensuring compliance and for detecting violations, not merely set out what conduct is prohibited.[269]

During the Relevant Period, WHM, through Murphy, failed to establish and maintain a supervisory system, including WSPs, reasonably designed to ensure compliance with Section 5 of the Securities Act and the rules enacted thereunder.

Murphy was responsible for maintaining current WSPs that accurately stated the procedures being followed by the firm. WHM, through Murphy, failed to establish and maintain adequate procedures tailored to its new line of business as the broker-dealer responsible for marketing and selling private placements issued by affiliates of LREA. WHM failed to have *any* WSPs setting out mechanisms for compliance with Section 5 of the Securities Act when marketing and selling private placements issued by LREA-affiliated companies to investors who were introduced to the investments via radio shows and workshops hosted by WHM registered persons.

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[267] WHM claims that it relied on advice of counsel. Ans. ¶ 144. However, advice of counsel is not a valid defense to this cause of action because scienter is not an element of a Section 5 violation. *Dep't of Enforcement v. Asensio Brokerage Services, Inc.*, No. CAF030067, 2006 NASD Discip. LEXIS 20, at *40 (NAC July 28, 2006) (citing *Dist. Bus. Conduct Comm. v. Goldsworthy*, No. C05940077, 2000 NASD Discip. LEXIS 13, at *35 (NAC Oct. 16, 2000), *aff'd*, *John Patrick Goldsworthy*, Exchange Act Release No. 45926, 2002 SEC LEXIS 1279 (May 15, 2002)).

[268] *See* IM-3010-1.

[269] *See Gary E. Bryant*, 51 S.E.C. 463 (1993); *John A. Chepak*, Exchange Act Release No. 42356, 2000 SEC LEXIS 97 (Jan. 24, 2000); *A.S. Goldmen & Co.*, Exchange Act Release No. 44328, 2001 SEC LEXIS 966 (May 21, 2001).

Neither Murphy nor Hutton were able to point to procedures (1) prohibiting customers obtained from radio shows and workshops from purchasing unregistered private placements that were available for sale before the customer established a substantive relationship with WHM; or (2) describing a review process wherein supervisors would verify that new customers were not being sold unregistered securities whose offerings had commenced before establishing a substantive relationship with WHM. The best that Hutton could do was to point to generic language in the WSPs stating that WHM would hold meetings to "discuss thoroughly the nature of any security or underwriting or offering in which the Company participates."

Murphy was also responsible for supervising the LREA OSJ. He was aware of the general solicitations because he monitored the radio shows and pre-approved the scripts. In addition, Murphy was the individual responsible for accepting customer accounts, and supervising all associated persons, advertising, and private placement activities. Despite his duties, Murphy failed to supervise the LREA OSJ, its registered persons, and its activities. Murphy's supervisory lapses allowed Price and Hutton to obtain new customers through general solicitation (radio shows and workshops) and sell those customers unregistered securities in offerings that had commenced before establishing a substantive relationship with them, in contravention of Section 5 of the Securities Act.

Price and Hutton's testimony exemplified how Murphy's supervisory lapses resulted in the firm's failure to ensure compliance with Section 5 of the Securities Act. For example, Price was so poorly supervised that she failed to even read the offering materials for the private placements she sold to WHM customers, except for the private placement in which she personally invested. Murphy failed to recognize that reading the offering materials would be important when qualifying prospective customers to invest in the offerings. Murphy testified he was not concerned that Price, a WHM registered representative, failed to read these offering materials. In addition, as a result of the firm's lack of supervisory procedures, Hutton, Price's WHM supervisor, made no effort to ensure customers were not placed into offerings open prior to the existence of a substantive relationship with the firm; instead, Hutton testified that he was not concerned about what offering a WHM customer purchased once the customer was referred over to the issuer.

WHM, through Murphy, used a cooling-off period when participating in the sales of the unregistered securities; however, it failed to establish and maintain procedures (1) defining an appropriate cooling-off period for private placements; (2) requiring customers to wait an appropriate cooling-off period before offering unregistered securities to them; and (3) describing a review process wherein supervisors would verify that customers waited the appropriate cooling-off period. In fact, Murphy testified that such procedures were unnecessary.

In light of the foregoing, the Panel concludes that WHM and Murphy violated NASD Rule 3010 and FINRA Rule 2010 by failing to establish and maintain a

supervisory system, including WSPs, reasonably designed to ensure compliance with Section 5 of the Securities Act and prevent the sale of unregistered, non-exempt securities.

IV. Sanctions

For the first cause of action, the Panel determined that the appropriate remedial sanctions for WHM are a $50,000 fine and disgorgement in the amount $78,210.91 plus interest to FINRA. For the second cause of action, WHM is fined $50,000, and Murphy is (1) fined $50,000, (2) suspended from associating with any FINRA member firm in all capacities for six months, and (3) required to re-qualify by examination as a registered representative and principal before he re-enters the securities industry in any capacity. Below is a discussion of the sanctions associated with each cause of action.

A. William H. Murphy & Co.'s Violation of FINRA Rule 2010 by Selling Unregistered, Non-Exempt Securities in Violation of Section 5

1. The Sanction Guidelines

FINRA's Sanction Guidelines ("Guidelines") for the sale of unregistered securities provide for a fine of $2,500 to $73,000 and, in egregious cases, for suspension of the firm with respect to any and all activities or functions for up to 30 business days or until procedural deficiencies are remedied.[270] The Guidelines further set forth specific considerations for such violations, four of which are applicable to this case: (1) whether the respondent attempted to comply with an exemption from registration; (2) share volume and dollar amount of transactions involved; (3) whether the respondent had implemented reasonable procedures to ensure that it did not participate in an unregistered distribution, and (4) whether the respondent disregarded "red flags" suggesting the presence of unregistered distribution.[271]

These factors demonstrate that WHM's violations should carry substantial sanctions. Although WHM claims it was attempting to comply with an exemption to registration, it ignored the plain language of SEC Rule 502(c) prohibiting general solicitation. In doing so, WHM ignored multiple red flags that should have alerted it that it was participating in a general solicitation of unregistered securities in contravention of Section 5. In addition, WHM failed to implement reasonable procedures to ensure that they did not participate in selling unregistered securities. Moreover, the share volume and dollar amount of transactions at issue was substantial—the private placement transactions were approximately $3 million, which included sales to unaccredited investors.

[270] FINRA Sanction Guidelines at 24 (2015), http://www.finra.org/industry/sanction-guidelines.

[271] *Id.*

2. Aggravating Factors

The Panel also considered the Principal Considerations in Determining Sanctions, a list of factors that should be considered in conjunction with the imposition of sanctions with respect to all violations.[272] Several aggravating factors are applicable here.

First, WHM's misconduct was intentional or at a minimum reckless. WHM established a business model that funneled investors to the issuers. WHM fully understood the business model as Murphy had met with Stone, LREA's owner, and the managers of the private placement offerings, prior to entering into the OSJ Agreement and the Agreement with LREA. On some level, Murphy knew this model was risky. He testified that when Price and Hutton wore two hats, it bothered him, noting that "[n]o man can serve two masters."[273] That said, he anticipated that Stone would create a lucrative business and accepted LREA as an OSJ. When WHM decided to take on LREA, Murphy testified that he told his counsel, "okay, how do we paper this up so we don't have potential problems down the road."[274]

Second, WHM refused to accept responsibility for its participation in the sales of the unregistered securities. The entities were set up specifically for the purpose of generally soliciting the public in a manner designed to skirt the registration requirements of the Securities Act. Murphy knew that the business model involved radio shows and workshops and he expected sales of the unregistered securities. That said, WHM, through Murphy, never acknowledged that the radio shows and workshops were used to solicit new customers to whom to sell unregistered securities and that it was a mistake to participate in this business model.

Third, WHM's misconduct resulted in financial gain. When WHM created this business model, Murphy negotiated a monthly retainer fee and a commission on the sales of the unregistered securities from the issuers. WHM received $78,210.05 from the commissions and monthly fees.

Lastly, the Panel was extremely troubled by WHM's creation of the Amended Agreement. WHM created the Amended Agreement in order to improperly give the appearance that LREA was not participating in selling unregistered securities in offerings at issue in this matter. The Amended Agreement removed language contained in the original Agreement, dated and executed on March 15, 2011, pertaining to LREA offering securities of related issuers. It also added an entire section on "educational activities" and other language related to workshops to change the appearance of LREA's activities away from participating in selling unregistered securities of affiliated issuers. In addition, the

[272] *Id*. at 6-7.

[273] Tr. 1160.

[274] Tr. 1161.

Amended Agreement was not produced to FINRA staff during the exam. WHM's attempt to mislead the Panel with this document constitutes a significant aggravating factor.

3. Lack of Mitigating Factors

WHM claimed that it relied on outside counsel and this should be considered mitigating. To show reliance of counsel as a mitigating factor, WHM was required to show: (1) advice sought on legality of proposed action; (2) complete disclosure of relevant facts to counsel; (3) advice received from counsel that proposed action would be legal; and (4) reliance in good faith on counsel's advice.[275]

Based on Murphy's testimony, reliance on counsel is not a mitigating factor in this case. According to Murphy, he did not seek counsel's advice regarding whether the radio shows and workshops constituted general solicitation or how to supervise them.[276] Moreover, Murphy did not ask his attorney if WHM should include red flags in the firm's WSPs regarding the radio shows and workshops.[277] Because WHM, through Murphy, did not rely on advice of counsel regarding the legality of the above topics, WHM cannot establish good faith reliance on the advice of counsel.

4. Conclusion

Based on the foregoing, the Panel determined that WHM's misconduct warranted significant sanctions. First, the Panel determined that a $50,000 fine is an appropriate remedial sanction.

Second, the Panel determined that disgorgement is also appropriate. The Guidelines direct adjudicators to consider a respondent's ill-gotten gains when determining an appropriate remedy. When the respondent has obtained a financial benefit from the misconduct, adjudicators may, where appropriate, order disgorgement of some or all of the financial benefit derived, directly or indirectly.[278] Here, given the aggravating factors described above, we find that it is appropriate to strip WHM of its ill-gotten gains, namely, the commissions and monthly retainer fees derived from the misconduct.

Therefore, we find that in addition to the $50,000 fine, WHM is required to disgorge to FINRA its commissions and retainer fees generated from the business model

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[275] *Gallagher & Co.*, 50 S.E.C. 557, 563 n.15 (1991), *aff'd per curiam*, *Gallagher & Co. v. SEC*, 963 F.2d 385 (11th Cir. 1992), SEC Docket No. 91-5476 (unpublished opinion), *cert. denied*, 113 S. Ct. 477 (1992) (citing *SEC v. Savoy Industries, Inc.*, 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981)); *SEC v. Goldfield Deep Mines Co. of Nevada*, 758 F.2d 459, 467 (9th Cir. 1985).

[276] Tr. 1874-76.

[277] Tr. 1232-33.

[278] Guidelines at 4-5 (General Principles Applicable to All Sanction Determinations, No. 6).

it established to participate in the sales of the unregistered securities.[279] Finally, we exercise our discretion under the Guidelines and impose pre-judgment interest on the disgorgement.[280] The Panel also orders that WHM pay pre-judgment interest beginning from February 1, 2013, until disgorgement is paid.[281] Pre-judgment interest is a matter of discretion for an adjudicator.[282] Where a violator has enjoyed access to funds over a period of time as a result of his wrongdoing, requiring the violator to pay pre-judgment interest is consistent with the equitable purpose of disgorgement.[283]

B. William H. Murphy & Co., Inc. and William H. Murphy's Violations of NASD Rule 3010 and FINRA Rule 2010

For supervisory violations, the Guidelines recommend suspending the responsible individual in all supervisory capacities for up to 30 business days. In egregious cases, the Guidelines recommend suspending the responsible individual in any and all capacities for up to two years or imposing a bar. In a case against a member firm, the Guidelines recommend, in egregious cases, suspending the firm with respect to any and all activities or functions for up to two years or expulsion. The Guidelines further recommend the imposition of a fine between $5,000 and $73,000.[284] The specific considerations for failure to supervise are (1) whether the respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny; (2) the nature, extent, size and character of the underlying misconduct; and (3) the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls.

The Guidelines for deficient supervisory procedures recommend a fine between $1,000 and $37,000 and, in egregious cases, suspending the responsible individual in any or all capacities for up to one year. For member firms, the Guidelines recommend suspending the firm with respect to any and all activities or functions until the procedures are amended to conform to the rule requirements.[285] The specific considerations direct adjudicators to consider whether the deficiencies (1) allowed violative conduct to occur

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[279] Guidelines at 4-5 (General Principles Applicable to All Sanction Determinations, No. 6) (Adjudicators should consider requiring respondent to disgorge ill-gotten gains.).

[280] *See Department of Enforcement v. Davidofsky*, No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at *43 (NAC Apr. 26, 2013) ("When assessing disgorgement, FINRA adjudicators should require payment of prejudgment interest on the amount to be disgorged, or explain in their decision why the payment of prejudgment interest is not appropriate to effectuate the purposes of equitable disgorgement. The rate of prejudgment interest is the rate established for the underpayment of income taxes in the Internal Revenue Code, which is the same rate we use when ordering interest on a restitution award.").

[281] This date is the end of the almost two-year Relevant Period defined in the Complaint.

[282] *SEC v. Hughes Capital Corp.*, 917 F. Supp. 1080, 1089 (D.N.J. 1996).

[283] *Id*. at 1090.

[284] Guidelines at 103.

[285] *Id*. at 104.

or escape detection, and (2) made it difficult to determine the individual or individuals responsible for specific areas of supervision or compliance.[286]

As discussed above, there were several red flags that should have alerted Respondents that they were participating in improper sales of unregistered securities. Murphy, as the President and CCO, was tasked with supervising LREA. He was fully aware of the use of radio shows and workshops. He also knew that the radio shows and workshops would create an interest in the private placement offerings. He failed to effectively supervise the business model he set up to ensure that no general solicitation occurred. Respondents also knew, or should have known through their review of LREA's email and the CRM system, that LREA was tracking the ideal customer based on sales, not education. The supervisory failures permitted improper sales of unregistered securities to take place over nearly two years, during which approximately $3 million in unregistered securities were sold 23 investors, several of whom were unaccredited.

Murphy, as the CCO, was responsible for the WSPs; yet, he failed to revise WHM's WSPs to include any procedures to supervise its new business venture with LREA and the issuers. The WSPs did not include LREA or its activities; therefore, the WSPs did not specify who was responsible for these omitted activities. These failures led to investors purchasing unregistered securities that were not subject to an exemption from registration.

The Guidelines explain that the principal goal of sanctions is "to protect the investing public, support and improve the overall business standards in the securities industry, and decrease the likelihood of recurrence of misconduct by the disciplined respondent."[287] In this case, the Panel determined that the Respondents misconduct was egregious. The Panel found that WHM and Murphy's demonstrated disregard of Conduct Rule 3010 poses a serious risk to the investing public. The Panel concluded that the appropriate sanctions under the facts and circumstances of this case are as follows: WHM is fined $50,000. Murphy is (1) fined $50,000, (2) suspended for six months in all capacities, and (3) required to re-qualify by examination before he re-enters the securities industry in any capacity. The Panel determines that re-qualification is necessary because Murphy lacks sufficient knowledge and familiarity with the rules and laws governing the sale of unregistered securities. The record sufficiently demonstrated a number of "red flags" concerning the sales of the unregistered securities, which Murphy ignored.

[286] *Id.*

[287] *Id.* at 2.

V. Order

Respondent WHM violated FINRA Rule 2010 by selling unregistered securities in violation of Section 5 of the Securities Act of 1933. For this violation, WHM is fined $50,000 and ordered to disgorge $78,210.91 plus interest to FINRA.[288]

Respondents WHM and Murphy violated NASD Rule 3010 and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to ensure compliance with Section 5 of the Securities Act. For this violation, WHM is fined $50,000 and Murphy is (1) fined $50,000, (2) suspended from associating with any FINRA member firm in all capacities for six months, and (3) required to re-qualify by examination before he re-enters the securities industry in any capacity.[289]

In addition, Respondents are ordered to pay the costs of this proceeding in the amount of $15,888.48, which includes an administrative fee of $750 and hearing transcript costs of $15,138.48.

If this Decision becomes FINRA's final disciplinary action, the suspension shall become effective with the opening of business on Monday, August 1, 2016. The fines, disgorgement, and assessed costs shall be due on a date set by FINRA, but not less than 30 days after this Decision becomes FINRA's final disciplinary action in this proceeding.

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Maureen A. Delaney
Hearing Officer
For the Extended Hearing Panel

[288] The interest shall run from February 1, 2013, the end of the Relevant Period, until paid. The interest rate shall be the rate established for the underpayment of income taxes in Section 6621 of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2). Guidelines at 11. *See supra* footnote 281.

[289] The Panel considered all of the parties' arguments. They are rejected or sustained to the extent that they are inconsistent with the views expressed herein.

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