BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of District Business Conduct Committee For District No. 3, Complainant, vs. Kevin D. Kunz Fruit Heights, UT, and Kunz and Cline Inc. Management, Inc., Salt Lake City, UT, Respondents.	DECISION Complaint No. C3A960029 Dated: July 7, 1999

Broker/dealer and principal violated prohibitions on making material misrepresentations and omissions, on offering unregistered securities that are not exempt and on making unsuitable recommendations. Principal violated restriction on paying unregistered person money in connection with the solicitation of securities transactions. Held, findings and sanctions affirmed in part and modified in part.

Kunz and Cline Investment Management, Inc. ("K&C" or the "Firm") and Kevin D. Kunz ("Kunz") appealed a November 3, 1997 decision of the District Business Conduct Committee for District No. 3 ("DBCC"). For the reasons discussed below, we find that respondents sold VesCor Capital Corporation ("VesCor") securities pursuant to private placement memoranda ("PPMs") containing material misrepresentations and omissions, in violation of Conduct Rule 2110. We also find that respondents violated Conduct Rule 2110 when they sold VesCor securities that were neither registered under the Securities Act of 1933 ("1933 Act") nor exempt from registration, in contravention of Section 5 of the 1933 Act. We further find that Kunz violated Conduct Rule 2110 by compensating an unregistered person in connection with the sale of securities. However, we reverse and dismiss the DBCC's finding that respondents violated Conduct Rules 2110 and 2310 by making unsuitable recommendations to customers.

We order that respondents be censured and fined $20,000, jointly and severally. Additionally, we order that Kunz be fined $5,000, individually. We also order that Kunz be suspended from associating with any member firm in a representative capacity for 30 calendar days and in a principal capacity for one year, such suspensions to run concurrently. Kunz is ordered to requalify in a representative capacity within 90 days of the conclusion of his suspension as a representative or cease to function in such capacity until he so requalifies and to requalify in a principal capacity before functioning in such capacity after the conclusion of his principal suspension. In addition, K&C is ordered to retain an independent consultant, as detailed below. Finally, we uphold the DBCC's imposition of $2,597.20 in hearing costs, joint and several.

Background

K&C became a member of the NASD in December 1994. Kunz first became associated with an NASD broker/dealer in June 1984 as a registered representative. He formed K&C with Jeffrey Cline ("Cline") in December 1994. Kunz is registered as a general securities representative and principal with K&C.

Factual and Procedural History

The DBCC filed a four-cause complaint against K&C, Kunz, and Cline on August 21, 1996. The four causes of action listed in the complaint, discussed in detail below, relate to the purchase or sale of securities issued by VesCor between approximately December 13, 1994 and September 30, 1995. All of the respondents submitted answers denying the substantive allegations in the complaint. Shortly after filing an answer, Cline submitted an Offer of Settlement that was accepted by NASD Regulation, Inc. ("NASD Regulation") and, therefore, we do not specifically address the allegations as to him. During the two-day DBCC hearing, the remaining parties introduced testimonial and documentary evidence.

According to this evidence, VesCor's business consisted of the origination, purchase and sale of loans secured by real property. To finance its business, VesCor obtained funds from members of the public through the sale of certain investment vehicles, including: Wholesale Accrual Notes ("Accrual Notes"), Wholesale Monthly Income Notes ("Monthly Notes"), and Wholesale Mortgage Loan Participation Interests ("Mortgage Loan Participation Interests").

Persons investing in the Accrual Notes and Monthly Notes received an assignment of VesCor's equity in a series of wholesale mortgage trusts, i.e., the investors received notes of VesCor. Persons investing in the Accrual Notes received interest, accrued monthly, at 12 percent per annum. Persons investing in the Monthly Notes received interest, payable monthly, at 10 percent per annum. The funds VesCor obtained from the sales of these notes were commingled with those of other investors to support VesCor's business.

Under the Mortgage Loan Participation Interests program, investors provided funds to VesCor to be used to originate or acquire mortgages, with the investor's name appearing on the security documentation in proportion to the percentage of the mortgage financing he or she provided. Investors were named beneficiaries on the trust deeds. The funds from the sales of Mortgage Loan Participation Interests were kept in money market accounts pending allocation to a specific mortgage. The investors' rate of return depended on the rate paid on the underlying mortgage. The PPMs for the Mortgage Loan Participation Interests stated that the target return was 12 percent. Each of the three investment vehicles allowed the customer to invest for a period of 30, 45 or 60 months.

Prior to 1994, VesCor sold all three investment instruments without registering them with the Securities and Exchange Commission ("SEC") and without reference to the 1933 Act or any regulations promulgated thereunder. According to information provided during the DBCC hearing, VesCor was apparently proceeding under the belief that both types of notes and the Mortgage Loan Participation Interests were simply investments in real estate, not securities. In early 1994, however, the State of Nevada commenced an inquiry into the VesCor program and concluded that the notes and Mortgage Loan Participation Interests were securities. Faced with such information, VesCor agreed to a settlement with Nevada wherein VesCor was required to make a rescission offer to existing holders of the notes and Mortgage Loan Participation Interests in Nevada. VesCor also offered rescission to investors in other states and sought to raise new funds.

According to Kunz, he originally became acquainted with VesCor and Val Southwick ("Southwick"), VesCor's president, in 1987.[1] In August 1994, Kunz joined VesCor as an employee. Kunz testified that, based upon comments made to him by Southwick, he expected to be able to take over management of VesCor approximately five years after his starting date, because Southwick planned to retire. Shortly after Kunz arrived, however, Southwick determined that the rescission offerings should be handled through a registered broker/dealer. At the encouragement of Southwick, Kunz then left VesCor to form a broker/dealer with Cline. Southwick agreed to provide Kunz and Cline the funds needed to form a broker/dealer. With Cline's assistance, Kunz began the NASD member application process in September 1994.

While Kunz and Cline were in the process of forming a brokerage firm, Kunz was also working as a consultant for VesCor. Kunz testified that, in his consulting role, he provided advice to VesCor on how the PPMs related to the rescission offerings should be "put together," as well as performing certain other duties. Although he denied actually drafting the documents, Kunz stated that he had assisted in preparing certain language used in the PPMs. VesCor, Southwick and Kunz anticipated that K&C, once it was formed and registered with the NASD,

[1] Kunz testified that he met Southwick through a mutual acquaintance in 1987. Kunz stated that, at that time, Southwick offered him the opportunity to participate in the sales of VesCor notes similar to those described above. Kunz initially declined, however, because he believed that the notes were "securities" and that his participation in VesCor's program might have violated the NASD's selling-away rules because he was working as a registered representative with a broker/dealer.

would act as selling agent or underwriter for the private placement offerings and possibly for an anticipated, subsequent "SB-2 public offering."[2]

On December 13, 1994, the NASD approved K&C's membership application. The VesCor transactions in question commenced immediately thereafter. VesCor created a total of six PPMs for the simultaneous private offerings, including two different PPMs for each of the three investment vehicles, the Accrual Notes, Monthly Notes and Mortgage Loan Participation Interests. One set of three was used for residents of Nevada, and another set of three was used for residents of other states. Each PPM indicated that the VesCor notes and Mortgage Loan Participation Interests were securities. Each PPM also provided that the investment instruments would not be registered under the 1933 Act or any state securities laws, evidently based on VesCor's belief that they were exempt from such registration under SEC Rule 506 of Regulation D, promulgated pursuant to the 1933 Act, discussed infra. The three PPMs used for Nevada residents contained a disclosure about Southwick's litigation history, as required by VesCor's settlement with Nevada. The remaining PPMs did not include this disclosure. Each of the PPMs was used not only to offer rescission to prior purchasers of the VesCor instruments but also to solicit additional or new investments.

All six PPMs used the same financial statement, which was audited by a certified public accountant and which reflected an accumulated net operating loss of approximately $2.6 million, assets of approximately $14.8 million and liabilities of approximately $6.4 million. VesCor's largest listed asset was an undeveloped, 20,000-acre parcel of land -- consisting of four, 5,000-acre tracts -- located in Cannon County, Tennessee ("Tennessee Land"), allegedly valued at $9.2 million. This asset caused VesCor to appear to have a positive net worth.[3]

VesCor purportedly purchased the Tennessee Land from Resource Land Development Corporation ("Resource Land") for 750 shares of VesCor restricted stock. VesCor's alleged purchase of the Tennessee Land occurred on September 26, 1994, four days prior to the "as of" date for the audited financial statement used in the PPMs. VesCor's financial statement listed the 750 shares that it transferred for the Tennessee Land as being valued at $12,177.85 per share. VesCor's financial statement, however, also indicated that, just 11 days before acquiring the Tennessee Land, VesCor had issued restricted shares of its stock valued at $63.80 per share in exchange for services rendered. The financial statement did not provide any explanation for the discrepancy in valuation of the shares during this period.

In all, K&C, through Kunz, provided one or more of the PPMs to 102 individuals, 80 of whom were unaccredited investors.[4] There is no dispute, moreover, that K&C, through Kunz,

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[2] SEC Form SB-2 is an alternative registration form that can be used by small business issuers (defined in SEC Rule 405 as businesses with revenues of less than $25 million) for certain public offerings.

[3] Without the Tennessee Land, VesCor's assets totaled approximately $5.6 million, a sum which was approximately $800,000 less than the sum of its liabilities.

[4] Kunz testified that, although only 18 of the 102 investors were his customers, he delivered, either personally or by mail, the PPMs to most, if not all, of K&C's customers.

provided PPMs for the Accrual Notes alone to more than 35 unaccredited investors, a number pertinent to a claim of exemption under Rule 506 of Regulation D, discussed below as part of the analysis of the second cause of action.[5]

NASD Regulation staff also presented evidence at the DBCC hearing regarding certain individuals' investment objectives, income and net worth. The staff submitted documentary evidence from various sources, including: (1) subscription documentation completed by the investors; (2) new account cards completed by K&C to establish customer accounts; and (3) questionnaires that NASD Regulation staff sent to all of the investors (48 of the investors completed the questionnaires and returned them to staff). None of the investors were called as witnesses by either party at the DBCC hearing.

Finally, NASD Regulation staff presented evidence that K&C, through Kunz, had made certain payments, in the approximate aggregate amount of $89,000, to an unregistered K&C employee, Bruce Anderson ("Anderson"). Staff argued that these payments represented hidden commission payments to an unregistered person in connection with offers and sales of VesCor securities. Kunz testified that, although a Form U-4 had been submitted to NASD Regulation to allow Anderson to become registered with K&C, the registration had never become effective. Kunz explained that K&C had intended to associate Anderson as a principal and manager of its Las Vegas office, but that Anderson, who had qualified as a representative under the old Series 1 examination and expected to be grandfathered in that capacity for purposes of becoming a principal, had been informed that he would have to take both the Series 7 and 24 examinations to qualify. According to Kunz, Anderson did not wish to take the Series 7 examination and withdrew his application for registration. Anderson then entered into a consulting relationship with K&C. Kunz acknowledged during the DBCC hearing that it was his intention to pay Anderson what he would have earned in commissions for his VesCor customers.

On November 3, 1997, the DBCC issued its decision. Under the first cause of action, the DBCC found that K&C, through Kunz, offered and sold securities to the public pursuant to PPMs that contained material misrepresentations and omissions, in violation of Conduct Rule 2110. The DBCC did not find, however, that the same conduct violated Conduct Rule 2120, the NASD's anti-fraud provision, and the DBCC dismissed the first cause of action to the extent it alleged a violation of such provision. With regard to the second cause of action, the DBCC found that K&C, through Kunz, offered and sold securities that were neither registered nor exempt from registration, in contravention of Section 5 of the 1933 Act and in violation of Conduct Rule 2110. As to the third cause of action, the DBCC found that K&C, through Kunz, recommended the purchase of securities to customers for whom the recommendation was unsuitable in light of their financial circumstances and needs, in violation of Conduct Rules 2110

[5] Kunz testified at the DBCC hearing that his investigation led him to conclude that more than 35 unaccredited individuals purchased or retained Monthly Notes as well. It is, however, unclear from a review of the documents submitted during the DBCC hearing whether Kunz's admission that there were more than 35 unaccredited individuals for both types of notes is accurate. Accordingly, because Kunz may have been mistaken in his conclusion, we analyze the allegations related to respondents' selling of unregistered securities, discussed below, under the assumption that there were more than 35 unaccredited individuals who purchased the Accrual Notes but not the Monthly Notes.

and 2310. The DBCC, however, dismissed this cause of action as to one customer. Finally, in relation to the fourth cause of action, the DBCC held that Kunz had compensated an individual for securities transactions when such individual was not registered with the firm as a representative, in violation of Conduct Rule 2110.

The DBCC censured K&C and Kunz and fined them $30,000, jointly and severally, for the violations alleged in the first three causes of action (consisting of joint and several fines of $10,000 each for the violations found under causes one, two and three of the complaint). In addition, the DBCC imposed a $5,000 fine on Kunz individually for the violation found under cause four and suspended him from association with any member in a representative capacity for one month and in a principal capacity for one year. The DBCC also required that Kunz requalify by examination as a representative and as a principal. In addition, the DBCC imposed an independent consultant requirement related to K&C's participation in any public or private offering of securities in the capacities of lead underwriter or primary placement or sales agent. Finally, K&C and Kunz were assessed $2,597.20 in costs, jointly and severally, for the DBCC hearing. This appeal followed.

Discussion

As described above, the complaint in this matter listed four causes of action. Each cause of action will be discussed separately below. As an initial matter, however, we review whether the Accrual Notes, Monthly Notes, and Mortgage Loan Participation Interests are properly characterized as securities. We find that they are securities. In support of this finding, we note that the parties do not dispute that these investment vehicles are securities. Moreover, our independent review and analysis of the facts of this case, and of relevant precedent, support this conclusion.

The Accrual Notes and Monthly Notes are, as their names suggest, notes in that the investors agreed to contribute money to VesCor and VesCor agreed to repay them principal plus interest of 12 and 10 percent respectively. Under the United States Supreme Court's "family resemblance" test enunciated in Reves v. Ernst & Young, 494 U.S. 56, 62-70 (1990), every note is first presumed to be a security, but the presumption may fall away under either step of a two-tiered analysis. In the first step, the notes under review are compared with several types of notes that the Court specifically determined are not securities.[6] The comparison between the note(s) in

[6] The types of notes that the Court found not to be securities include the following:

> [T]he note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized)[, and] . . . notes evidencing loans by commercial banks for current operations.

Reves, 494 U.S. at 65.

question and the excluded notes is to be made by considering four factors: (1) "the motivations that would prompt a reasonable seller and buyer to enter into [the transaction]," (2) "the 'plan of distribution' of the instrument," (3) "the reasonable expectations of the investing public," and (4) "whether some factors such as the existence of another regulatory scheme significantly reduced the risk of the instrument, thereby rendering application of the Securities Acts unnecessary." Id. at 66-67.

The note is not a security if this four-factor comparison reveals a "strong resemblance" to one of the enumerated types of notes. Id. at 67. If a strong resemblance is not found, the reviewing body invokes the second step of the analysis, namely, "the decision whether another category should be added." Id. This decision "is to be made by examining the same [four] factors." Id.

Under the first Reves factor, we assess the motivations that would prompt a reasonable seller and buyer to enter into the transaction. An instrument is likely to be a security "[i]f the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate." Id. at 66. Conversely, if the "note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose . . . the note is less sensibly described as a 'security.'" Id.

We have little difficulty concluding that VesCor's main purpose for using the notes points in the direction of their being securities. The notes were expressly used to support VesCor's general business. The funds obtained from the sales of these notes were commingled with the funds of other investors to support VesCor's business. Moreover, VesCor's investors were primarily motivated by the opportunity to earn a profit on their money in the form of interest. The subscription agreements signed by the investors provided that the VesCor notes were investments and that investors would receive a stated rate of interest, 12 percent on the Accrual Notes and 10 percent on the Monthly Notes. In addition, questionnaires executed by a number of the investors clearly indicate that the investors were motivated by the chance to receive a good rate of return on their principal. As courts have explained, a favorable interest rate indicates that profit was the primary goal of the lender. Reves, 494 U.S. at 67-68; Stoiber v. SEC, 161 F.3d 745, 750 (D.C. Cir. 1998), cert. denied, 119 S. Ct. 1464 (1999).[7]

Under the second Reves factor, we examine the plan of distribution of the notes, focusing on whether the instruments were "offered and sold to a broad segment of the public. . . ." Reves, 494 U.S. at 68. Although there is no evidence that the notes were traded in a secondary market, the solicitation of more than 100 individuals strongly suggests that these notes were marketed and distributed as securities. The record indicates, moreover, that the purchasers were made up of a diverse, unrelated group.

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[7] It makes no difference, moreover, whether the rates are fixed or variable. See, e.g., Stoiber, 161 F.3d at 750; Pollack v. Laidlaw Holdings, Inc., 27 F.3d 808, 813 (2d Cir.), cert. denied, 513 U.S. 963 (1994) .

Applying the third Reves factor, we look to "the reasonable expectations of the investing public." Reves, 494 U.S. at 66. At this stage, the inquiry turns on whether the notes are reasonably viewed by purchasers as investments. See SEC v. Better Life Club of America, Inc., No. 98-5079, 1999 U.S. App. LEXIS 7319, at *9 (D.C. Cir. Mar. 24, 1999); Stoiber, 161 F.3d at 751 (citing Reves, 494 U.S. at 68-69; Pollack v. Laidlaw Holdings, Inc., 27 F.3d 808, 814 (2d Cir. 1994), cert denied, 513 U.S. 963 (1994); SEC v. R.G. Reynolds Enters., Inc., 952 F.2d 1125, 1131 (9th Cir. 1991)). The Supreme Court has explained that when a note seller describes a note as an investment, absent contrary indications, "[I]t would be reasonable for a prospective purchaser to take the [offeror] at its word." Reves, 494 U.S. at 69. See also Stoiber, 161 F.3d at 751; R.G. Reynolds, 952 F.2d at 1131. Here, the materials distributed to the public were replete with statements indicating not only that the notes were investments, but also that they were securities. Moreover, and as discussed above, a number of customers executed questionnaires indicating that they purchased the notes in order to receive favorable interest on their principal. In other words, the customers purchased the notes as investments. There are also no countervailing factors that would have led a reasonable person to question the characterization of the notes as investments.

The fourth Reves factor requires us to determine whether the adequacy of regulatory schemes other than the federal securities laws reduces the risk to the lender. We fail to find, and none of the parties has directed to our attention, any regulatory scheme providing an adequate substitute for the protection of the federal securities laws. See Pollack, 27 F.3d at 814-15 (rejecting contention that certain state laws related to mortgages provided adequate protection to investors of mortgage participation interests).

Viewed collectively, the Reves factors lead us to conclude that the Accrual Notes and Monthly Notes are securities. The notes in question do not bear a strong resemblance to any of the categories of notes declared by the Supreme Court to be outside the definition of securities, and the four factors do not suggest that these notes should be treated as a new non-security category.

With regard to the Mortgage Loan Participation Interests, a slightly different analysis must be applied to determine whether they are properly categorized as securities. The DBCC and the parties characterize this instrument as an investment contract. We agree and, therefore, apply the three-part test enunciated by the United States Supreme Court in SEC v. W.J. Howey Co., 328 U.S. 293 (1946), for determining whether an investment contract is a security. In Howey, the Court held that a particular transaction constitutes an "investment contract" security when: (1) a person invests his or her money (2) in a common enterprise and (3) is led to expect profits from the efforts of others. Id. at 298-99.

As to the first Howey factor, the record indicates that investors provided VesCor consideration in the form of the rejection of the right to rescind a prior investment, the election to credit accumulated interest to principal and/or cash if a new or additional investment was made. We find that this evidence satisfies the first prong of the Howey test.

The second Howey element, that there be a "common enterprise," has led courts to examine both "vertical" commonality and "horizontal" commonality. Vertical commonality, in general, requires only a pooling of the interests of the promoter and each investor, while horizontal commonality requires as well a pooling of interests among the investors. Courts have described horizontal commonality as "a wheel and not just a hub and a spoke." Wals v. Fox Hills Development Corp., 24 F.3d 1016, 1018 (7th Cir. 1994). We find that horizontal commonality exists in the present case, and there is no dispute that such evidence satisfies the second prong of the Howey test. Id. at 1017-18.

According to the offering materials, each investor agreed to make funds available to VesCor for a specified term for the purpose of acquiring and warehousing loans selected by VesCor for resale in the secondary market. The materials explained that VesCor would initially deposit all investor funds in separate investment accounts opened in each investor's name but that the investor funds would be invested from time to time at the direction of VesCor in short-term investments for secured real property loans purchased from or made to third parties. All loans in which the investor participated would be secured by a first mortgage or trust deed with the investor named as a beneficiary thereunder to the extent of his or her participation. A definite percentage of each such beneficial interest would then be calculated in order to identify each investor's fractional ownership in a loan. Thus, investor funds were pooled to purchase or make loans to third parties. Regarding compensation to VesCor, the offering materials stated that VesCor was entitled to keep, for its operating expenses and profits, all income from mortgage loans made by it in excess of the amounts of principal, interest and certain other fees due to the investors.

The investors and VesCor thus each sought to and could potentially financially benefit from the investment arrangement. Of course, there were also risks involved for all participants. Adverse changes in economic conditions -- such as fluctuations in prevailing interest rates, reduced demand for commercial loans, high vacancy rates, decreased real estate values, zoning changes, condemnation proceedings, etc. -- would affect the investors and VesCor pursuant to the arrangement, as would any mistakes or miscalculations made by VesCor. In brief, a pooling of interests clearly existed among the investors and VesCor, and all participants' fortunes would rise and fall together in a common enterprise.

The third Howey factor, that there be an expectation of profits from the efforts of others, is unquestionably present in this case. Investors in the Mortgage Loan Participation Interests expected to receive profits from their investments in the form of a substantial rate of return, projected by the offering materials to be 12 percent. The rate of return actually earned by the investors, however, depended on the rate paid on the underlying mortgage. The offering materials expressly stated that VesCor would make all decisions regarding its lending policies and the loans it made and that investors had to "rely on the Company and the Manager to carry out these responsibilities properly and competently." The offering materials also provided that VesCor intended to loan all or most of the proceeds from the offering to property owners that VesCor determined to be creditworthy.

In sum, all of the VesCor instruments at issue are securities. An analysis performed under the Reves and Howey tests supports this conclusion, and neither party argues to the contrary. We also find it is significant that the offering materials themselves stated that the instruments are securities. As the SEC has noted, "In the enforcement of an act such as [the Securities Act] it is not inappropriate that promoters' offerings be judged as being what they were represented to be." In re Ronald W. Gibbs, Exchange Act Rel. No. 35998 (Jul. 20, 1995). Cf. Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 (1985) ("[W]hen an instrument is both called a 'stock' and bears stock's usual characteristics, 'a purchaser justifiably [may] assume that the federal securities laws apply.'").[8] Having resolved this threshold issue, we now turn to the allegations of misconduct surrounding the sale of these securities, and related activities.

Cause One - Material Misrepresentations and Omissions. The first cause of action alleged, and the DBCC found, that K&C, through Kunz, sold VesCor securities pursuant to PPMs that contained a material misrepresentation in that each PPM listed on the company's balance sheet certain real property located in Tennessee valued at $9.2 million that the company did not own. The first cause also alleged that the PPMs contained material omissions, including the failure to disclose that Kunz had received compensation and loans from VesCor for consulting services and that such payments and advances had financed the establishment of the Firm, as well as the failure to disclose to prospective and actual purchasers in states other than Nevada that VesCor's president had been the subject of litigation arising out of the operations of a previous business similar in nature to VesCor. We will review these allegations separately, but we begin with a general discussion of the law in this area.

The first step in the analysis is to determine whether, in connection with the sale of a security, there was a misrepresentation or omission that was "material." The test of materiality is whether a reasonable investor would consider the information significant. Basic Inc. v. Levinson, 485 U.S. 224, 231-232 (1988). Put another way, would the misstated or omitted fact have been viewed by a reasonable investor as having altered the "total mix" of information made available? TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). The "reasonable investor" standard is an objective one. Id. at 445.[9]

If the first step is satisfied, the analysis then focuses on whether the respondent may be held liable for the misleading disclosure. We note in this regard that, when a broker/dealer acts as a selling agent and provider of a PPM, the broker/dealer accepts the duty to perform some level of review of the offering material and to ensure that such review has not uncovered any incomplete or inaccurate information. See, e.g., In re Everest Secs., Inc., Exchange Act Rel. No. 37600, at 6-9 (Aug. 26, 1996) (broker/dealer acting as selling agent and provider of a PPM was under a duty to investigate the subject securities), aff'd, 116 F.3d 1235 (8th Cir. 1997); In re

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[8] Furthermore, if the investment is marketed by a securities broker, as was the case here, it is more likely to fall under the securities laws. Cf. Pollack, 27 F.3d at 813-14; Mercer v. Jaffe, Snider, Raitt and Heuer, 736 F. Supp. 764, 769 (W.D. Mich. 1990), aff'd sub nom., Schreimer v. Greenburg, 931 F.2d 893 (6th Cir. 1991) (table format).

[9] We note as well that, unlike in some private-party actions, proof of customer reliance is not a necessary element in an enforcement action. See In re Lester Kuznetz, 48 S.E.C. 551, 554 (1986), aff'd, 828 F.2d 844 (D.C. Cir. 1987) (table format).

Kidder Peabody & Co., 46 S.E.C. 928, 930 (1977) (explaining that a selling agent must "exercise reasonable care in ascertaining the truth of . . . representations made in the offering circular and in insuring that the offering circular [does] not omit to state material facts.").[10] Accordingly, a respondent may be found to have violated the securities laws where he or she fails to perform a "reasonable" investigation of statements made in a PPM and of the subject security. Whether a particular investigation is deemed to be reasonable, thereby absolving the respondent of liability, will depend on the facts and circumstances of the particular case. See In re Thomas J. Fittin, 50 S.E.C. 544, 548 (1991).

In this case, we find that the VesCor PPMs contained materially misleading information. We also find that respondents' duty to investigate the accuracy of the statements made in the VesCor PPMs was heightened because of numerous "red flags" indicating that certain information was misleading. We further find that respondents distributed the offering materials without performing a reasonable investigation under the circumstances, in violation of Conduct Rule 2110.

With regard to the Tennessee Land, a preponderance of the evidence shows that VesCor improperly listed such property as a valid company asset. During the DBCC hearing, NASD Regulation staff introduced the special warranty deed[11] conveying Resource Land's interest in the Tennessee Land to VesCor. This deed, which was executed on September 26, 1994, only four days prior to the "as of" date for the financial statement used in the PPMs, described the four tracts making up the property merely as "land grant" numbers 4974, 4968, 4972, and 4969.[12] The deed provided no further description of the land.

Staff also introduced a "Preliminary Estimate of Value," prepared for VesCor, indicating that the Tennessee Land was worth $750 per acre, for a total value of $15 million. The Preliminary Estimate of Value, however, stated that: (1) it was not an appraisal or an evaluation; (2) the estimator had not personally inspected the property; (3) no surveys or exact locations had been provided to the estimator; and (4) the land grants needed to be converted into actual ground

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[10] Indeed, the SEC has stated that, under such circumstances, professional standards of the securities industry require more than uncritical reliance on information provided by the issuer. See Everest Secs., supra, 7-8.

[11] Three basic types of deeds are employed to convey property in the United States. These are the general warranty deed, the special warranty deed, and the quit claim deed. The general warranty deed indicates to the purchaser that the title is not defective and usually contains six covenants of title -- the covenant of seisin, the covenant of the right to convey, the covenant against encumbrances, the covenant of quiet enjoyment, the covenant of warranty, and the covenant of further assurances. The grantor warrants that the title is free from any defects. A special warranty deed, like that used here, contains the same covenants as a general warranty deed. This deed, however, does not provide as much protection to the grantee because the grantor warrants only that he did not cause any defects in title. He does not warrant against any and all title defects. The least measure of protection to a grantee is found in the quit claim deed. This deed contains no covenants and the grantor conveys only the interest he holds in the property. See generally J. Bruce, et al., Modern Property Law 695-96 (1984).

[12] The agreement between Resource Land and VesCor evidencing the Tennessee Land transaction was also executed on September 26, 1994.

surveys corresponding to tax maps and parcel numbers in order for the property to be located and surveyed.

Furthermore, staff testified at the DBCC hearing that they had contacted Mark West ("West") of the Cannon County, Tennessee, Property Assessor's Office to obtain more information about the property. West informed staff by telephone that ownership of a "land grant," under Tennessee law, did not indicate ownership of any actual real property.[13] In follow-up correspondence, staff asked West whether the County Assessor's records indicated that VesCor, Southwick, Resource Land or three other entities whose names had surfaced during the investigation had owned property in Cannon County. In a handwritten note on staff's correspondence, West replied "no" as to all entities listed and indicated that, to the best of his knowledge, the four land grants had not been converted into legal descriptions.

Staff also submitted copies of the four land grants in question. Each was handwritten and originally dated in the 1820's. The property allegedly covered by these land grants was described with reference to then-existing landmarks. No contemporary legal description was provided with respect to any of the four parcels.

Additionally, staff introduced a copy of a survey report ("Survey") on the letterhead of True Line Company Land Surveyors ("True Line").[14] The Survey represented that the surveyor had reviewed the land grants and found them to be "in proper form." The Survey went on to generally describe Cannon County and its major roads, and stated:

> With my visible [sic] inspection surrounding this area without survey stakes, maps or land markings of the location of the grants, I can only say, to the best of my knowledge, I have found virgin land with vast potential. . . .

Like the Preliminary Estimate of Value, the Survey did not refer to any specifically identified pieces of property. Although the surveyor represented that "metes and bounds" descriptions were attached, staff stated that it had never received a version of the Survey with that information, and none was provided by respondents. Staff also testified that when it contacted True Line, the purported surveyor's wife, who stated that she prepared all of his correspondence, requested a copy of the Survey because she did not believe that she had prepared it. After receiving the copy, she contacted staff and advised them that the Survey was not authentic and the purported signature of her husband was a forgery. The surveyor's attorney later wrote to VesCor, and sent a copy to staff, affirming that the Survey was fraudulent and requesting additional information about its source.

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[13] The staff member who spoke with West memorialized the conversation shortly after it had taken place.

[14] Staff obtained the survey report from Kunz, who testified that he received it from VesCor, along with the special warranty deed, after the PPMs were distributed to investors.

In light of this evidence, we find that VesCor did not own the Tennessee Land and that inclusion of such property in the financial statement attached to the PPMs was a material misrepresentation. In addition, we find that a reasonable investor would certainly consider significant the knowledge that an issuer's largest listed asset, which caused the company to have a positive net worth, did not exist. See, e.g., Everest Secs., supra, at 5 (finding that misrepresentations in a PPM regarding issuer's business and financial status were material); In re Charles E. French, Exchange Act Rel. No. 37409 (July 8, 1996) (holding that one cannot successfully challenge the materiality of information about the financial condition, solvency and profitability of the entity responsible for the success or failure of an enterprise).[15]

We also find that respondents had a duty, which they did not discharge, to investigate whether the Tennessee Land was appropriately listed as an asset of VesCor. Kunz argues that he relied on the audited financial statements in determining that the Tennessee Land was a valid asset. While it may be reasonable for a broker/dealer to rely on financial statements audited by a certified public accountant in some situations, we do not believe that to be the case here.

There were numerous "red flags" in the PPMs that should have alerted respondents that they needed to investigate the matter. For instance, the Tennessee Land was by far the largest asset VesCor listed in the financial statement, it caused VesCor to have a positive net worth, and it was purchased a mere four days prior to the accountant's certification of the financial statement. Additionally, VesCor's financial statement provided that the Tennessee Land -- which the Preliminary Estimate of Value indicated was worth $15 million and VesCor's financial statement valued at approximately $9.2 million -- was purchased for 750 shares of VesCor stock, valued at $12,177.85 per share. The same financial statement, however, indicated that 11 days earlier, VesCor had issued shares of its stock valued at $63.80 per share in exchange for services rendered. The financial statement and other offering materials provided no explanation for the disparity in the value of VesCor's stock during this period, and the materials did not indicate that there were different classes of stock. Finally, VesCor was not in the business of purchasing undeveloped real property. Taken together, this information, which could be gleaned from the PPMs, should have raised serious questions in the minds of the respondents about the legitimacy of the Tennessee Land as an asset, especially in light of Kunz's familiarity with VesCor as a former VesCor employee and consultant.

Under these circumstances, respondents had a duty to perform some form of an investigation into whether VesCor actually owned the Tennessee Land, notwithstanding that the financials were audited by an accountant. See, e.g., Everest Secs., supra, at 8 (rejecting respondent's argument that his failure to investigate aged financial statements used in an offering

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15 See also San Leandro Emerg. Med. Group Profit Sharing Plan v. Philip Morris Cos., 75 F.3d 801, 810 (2d Cir. 1996) ("Material facts include not only information disclosing the earnings and distributions of a company but also those facts which affect the probable future of the company and those which may affect the desire of investors to buy, sell, or hold the company's securities."); SEC v. Holschuh, 694 F.2d 130, 142 (7th Cir. 1982) (finding a misrepresentation regarding certain leasable interests purportedly held by issuer was material); Dirks v. SEC, 681 F.2d 824 (D.C. Cir. 1982) (holding that fraudulently inflated assets were material), reversed on other grounds, 463 U.S. 646 (1983); SEC v. Softpoint, Inc., 958 F. Supp. 846, 863 (S.D.N.Y. 1997) (holding that an issuer's overstatement of certain revenues constituted a material misrepresentation), aff'd, 159 F.3d 1348 (2d Cir. 1998) (table format).

was justified based on information provided to him by the issuer and the issuer's accountants and lawyers). Yet, when respondents provided their customers the PPMs, respondents admittedly made no inquiry about the Tennessee Land. It was not until after respondents had provided the PPMs to their customers -- when Cline began a "due diligence" review for a prospective SB-2 public offering -- that Kunz requested additional information from VesCor about its assets.

We find that respondents' failure to perform any independent investigation in the face of numerous red flags resulted in the communication of material misstatements that constituted negligent misconduct under Conduct Rule 2110. We agree with the DBCC, however, that there is insufficient evidence of scienter to warrant a finding that respondents violated Conduct Rule 2120, the NASD's anti-fraud provision.

The DBCC also found respondents in violation of Conduct Rule 2110 for distributing PPMs that omitted material information. The first such omission relates to VesCor's failure to disclose the consulting relationship between VesCor and Kunz, the compensation VesCor paid to Kunz, and the fact that this compensation financed K&C. We find that such information was material and should have been disclosed. Indeed, it strains credibility to suggest that a reasonable investor would not have viewed a potential conflict of interest like that present here as having altered the total mix of information.

Respondents argue in their defense that: (1) K&C did not receive approval of its membership application from the NASD until approximately two weeks after the effective date of the PPMs; (2) K&C did not assist in preparing the PPMs; (3) Kunz was acting simply as an independent consultant, without any broker/dealer affiliation, when he assisted VesCor with the PPMs; and (4) VesCor had planned to distribute the PPMs to its existing note holders whether or not K&C received its membership approval in time to participate in the offering. Respondents further contend that, under these facts, VesCor's failure to disclose its relationship with K&C and Kunz was not a material omission and respondents' distribution of the PPMs was not, therefore, a violation of the NASD's rules.

Respondents' argument is unpersuasive. Kunz testified that when K&C was being formed, Kunz, Cline and VesCor anticipated that K&C would act as selling agent or underwriter for the private placement. There is also no dispute that while Kunz was assisting VesCor with the private placement in his role as a consultant, all three were aware that Kunz would be acting as a principal of K&C once it was formally established and that the consulting fees VesCor paid to Kunz were being used to finance the establishment of K&C.[16] Moreover, Kunz admits that, at least initially, he intended to establish K&C to assist VesCor with its private placement and anticipated SB-2 public offering and then to return to VesCor as an employee, in the hope that he would one day become its chief executive. As discussed above, we find that this information would have been considered significant to a reasonable investor.

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[16] Indeed, Kunz testified at the DBCC hearing that all of the money needed to establish K&C came from Southwick and that there were no other independent sources of funding.

Accordingly, respondents should not have provided the PPMs to customers without disclosing their close ties with VesCor. Respondents' distribution of the PPMs to customers without any disclosure of the relationship was a material omission, violative of Conduct Rule 2110. See, e.g., SEC v. Softpoint, Inc., 958 F. Supp. 846, 863 (S.D.N.Y. 1997) (stating that an issuer's failure to provide information about its payments to brokerage firms constituted material omissions), aff'd, 159 F.3d 1348 (2d Cir. 1998) (table format); In re Kevin Eric Shaughnessy, Exchange Act Rel. No. 40244, at 4 (July 22, 1998) (finding material omission where respondent recommended a security without disclosing his self-interest in the transactions); In re Michael A. Niebuhr, Exchange Act Rel. No. 36620 (Dec. 21, 1995) ("A salesperson must disclose all material facts, including 'adverse interest,' such as a self-interest that could influence a recommendation."). The fact that K&C did not receive the NASD's membership approval until two weeks after the original effective date of the PPMs does not suggest otherwise. Either the PPMs should have been amended (sometimes referred to as being "stickered") to include such a disclosure or, at the very least, K&C should have made a separate, written disclosure on its own and provided the disclosure to K&C customers who received the PPMs.

Kunz also argues, however, that he relied on VesCor's counsel's advice in concluding that such disclosure was unnecessary.[17] Kunz testified that, because VesCor's counsel was generally aware of the facts discussed above, he took the attorney's failure to require the disclosure to mean that it was not needed. Kunz's assertion provides him with no defense. The "advice of counsel" defense requires a showing that the party claiming it made a complete disclosure to counsel, sought advice as to the legality of his or her conduct, and relied on that advice in good faith. Markowski v. SEC, 34 F.3d 99, 104-05 (2d Cir. 1994). Even if these elements are proven, however, "such reliance is not a complete defense, but only one factor for consideration." Id. at 105. Here, Kunz's assertion fails on two levels. There is no clear evidence that he ever affirmatively asked VesCor's counsel whether the disclosure was required, and even if he had, it would not have been reasonable for him to have relied on the advice of the issuer's counsel. See, e.g., Sorrell v. SEC, 679 F.2d 1323, 1327 (9th Cir. 1982) ("A broker may not rely on counsel's advice when the attorney is an interested party."); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 182 (2d Cir. 1976) (broker/dealer could not rely on advice of issuer's counsel; to be considered a relevant factor, the advice must come from a wholly disinterested party), cert. denied, 434 U.S. 1009 (1978); In re Michael Ben Lavigne, 51 S.E.C. 1068, 1071 n.18 (1994) ("Lavigne may not rely on others' counsel but must obtain independent advice from his own counsel."), aff'd, 78 F.3d 593 (9th Cir. 1996) (table format).[18]

The second material omission alleged in the complaint, and found by the DBCC, regards VesCor's failure to include Southwick's litigation history in the non-Nevada PPMs. We agree that respondents' distribution of certain PPMs that were devoid of any mention of Southwick's

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[17] Kunz testified that neither he nor K&C retained separate counsel regarding any aspect of the VesCor private placement offering.

[18] We agree with the DBCC, however, that there is insufficient evidence of scienter to warrant a finding that respondents' conduct amounted to fraud, violative of Conduct Rule 2120.

litigation history, with full knowledge that such information was disclosed in the other VesCor PPMs, violated Conduct Rule 2110.

There is no dispute that Southwick played a key role in the success or failure of the investments at issue. Each PPM, in fact, began with the discussion of the company's management as follows:

> Val E. Southwick, President and Chief Executive Office . . . , has effective control of all aspects of the business of the Company. It is therefore important that current and prospective investors become acquainted with his and [the Chief Financial Officer's] backgrounds.

The PPMs then described Southwick's education and career-related background in real estate lending, including the fact that he began his career in real estate lending with an entity called Summit Systems, Inc. ("Summit"), where "his assignments included loan underwriting criteria and sourcing capital for the firm."

The non-Nevada PPMs then indicated that, in 1985, Southwick was president of VesCor Ltd., a predecessor company, and that he organized the present VesCor in 1990. These PPMs next stated that, during Southwick's tenure, VesCor's "assets and managed capital base" had increased to more than $18 million and that he had "built associate relations with over 160 institutional and other qualified note buyers which purchase[d] the Company's first trust deeds and notes."

The Nevada PPMs, on the other hand, stated that, because of his personal guarantees of certain of Summit's obligations, Southwick "had been and continued to be involved in various civil litigation proceedings, including civil judgements still outstanding in an aggregate original principal amount of $1,830,386.76." The Nevada PPMs also explained that Southwick personally guaranteed bank lines of credit that financed Summit's mortgage lending activities in Vernal, Utah during a period that Vernal was expanding and demand for mortgage lending was high. When real property values in Vernal later declined, Summit was forced to foreclose on certain properties and, therefore, lost its income stream from those properties. This passage further stated that Southwick "stepped in to satisfy any deficiencies to the banks from which Summit had borrowed some of the funds which it had invested in the foreclosed properties."[19]

We agree with the DBCC in its determination that Southwick's litigation history is material. The litigation history described in the Nevada PPMs appeared to be related to the type of activity in which VesCor engaged. In view of the pivotal role that Southwick played in

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[19] In addition, the Nevada PPMs referenced a lawsuit filed in 1985 by Greyhound Corp. against Summit and other defendants that, although ultimately unsuccessful, nonetheless cost the defendants substantial amounts to defend. These PPMs represented that some of the outstanding judgments related to legal fees and costs incurred in that litigation and that the remainder consist of "consumer and business credit claims which arose out of or related to the financial conditions described above." Finally, the Nevada PPMs stated that Southwick was working with his creditors to resolve the outstanding judgments.

VesCor, we find that all investors were entitled to this information. Absent disclosure of this litigation history, investors received only positive information about Southwick's background, a factor which the PPMs highlighted as an important consideration. Accordingly, we find that Southwick's litigation history would have been viewed by a reasonable investor as an important consideration in determining whether to purchase the VesCor investments. See, e.g., In re Thomas J. Fittin, 50 S.E.C. 544, 546 (1991) (finding failure to disclose that an individual important to the success or failure of the enterprise had recently been sued for using false information as a selling tool in another transaction to be a material omission); In re Gallagher & Co., 50 S.E.C. 557, 564 (1991) ("[A]n indictment for mail fraud of the person essential to the issuer's success was a material fact requiring disclosure."), aff'd, 963 F.2d 385 (11th Cir.) (table format), cert. denied, 506 US 979 (1992). Thus, respondents' distribution of PPMs to customers that omitted this information was a violation of Conduct Rule 2110.[20]

In light of the aforementioned discussion, we affirm the DBCC's findings as to the first cause of action that respondents offered and sold securities pursuant to PPMs that materially misrepresented VesCor's financial condition and omitted to disclose material information about the relationship between respondents and VesCor and about Southwick's litigation history. We also find such conduct to be inconsistent with high standards of commercial honor and just and equitable principles of trade, violative of Conduct Rule 2110. In addition, we agree with the DBCC's determination that there is insufficient evidence of scienter to support a finding of a violation of Conduct Rule 2120 and, therefore, we uphold the dismissal of the fraud allegations related to cause one.[21]

Cause Two - Offering Unregistered Securities to the Public. The second cause alleged, and the DBCC found, that K&C, through Kunz, sold VesCor securities that were not registered with the SEC and that were not exempt from registration. Section 5 of the 1933 Act provides in pertinent part that, "[u]nless a registration statement is in effect, it shall be unlawful for any person, directly or indirectly," to use the means or instrumentalities of interstate commerce to solicit, sell, or convey a security. Courts have stated that, in order to prove a violation of Section 5 in the enforcement context, the evidence must show that (1) no registration statement was in

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[20] Kunz claims that he also relied on VesCor's counsel's affirmative representation that Southwick's litigation history did not need to be provided to the non-Nevada customers. As we discussed above, however, we view Kunz's reliance on the issuer's counsel to be unreasonable and no defense. Nonetheless, we agree with the DBCC that there is insufficient evidence of scienter to warrant a finding that respondents' conduct amounted to fraud, violative of Conduct Rule 2120.

[21] The complaint alleged that respondents engaged in reckless activities warranting a finding that Conduct Rule 2120 had been violated. Although evidence of reckless conduct would certainly suffice to prove a violation of that rule, we agree with the DBCC that respondents' conduct -- albeit negligent and inconsistent with high standards of commercial honor and just and equitable principles of trade -- did not rise to the level of recklessness. With regard to the Tennessee Land, for instance, the financial statement listing this asset had been audited. In relation to the omissions, respondents were apparently under the mistaken belief that they could rely on VesCor's counsel to determine exactly what type of information had to be provided in the PPMs. Although we find this reliance to have been unreasonable, we determine that it does tend to lessen any evidence of fraudulent intent. Other evidence tending to negate a showing of fraud is that respondents fully cooperated during staff's investigation and never attempted to hide their actions.

effect as to the security; (2) respondents offered to sell or sold the security; and (3) respondents used the means of interstate commerce in connection with the offer or sale. See SEC v. Spence & Green Chemical Co., 612 F.2d 896, 901-02 (5th Cir. 1980), cert. denied, 449 U.S. 1082 (1981). Once such a showing is made, the burden then shifts to respondent to demonstrate that the securities were exempt from the registration requirement. SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953).

There is no dispute that the VesCor securities were not registered with the SEC. The evidence also clearly shows that respondents offered to sell and sold VesCor securities to K&C customers. Moreover, Kunz testified that he mailed VesCor PPMs to a number of K&C customers and that he discussed the investments with some customers telephonically. Accordingly, the three elements discussed above are present in this case. Respondents assert, however, that the VesCor securities are exempt from registration under either SEC Rule 506 of Regulation D, or Section 4(2) of the 1933 Act.

Rule 506 provides a "safe harbor" exemption for the offer and sale of securities that satisfy all of the requirements of Rules 501 and 502, that do not involve more than 35 unaccredited investors and where any unaccredited investors involved have "such knowledge and experience in financial and business matters that [they are] capable of evaluating the merits and risks of the prospective investment." Rule 501 is simply the definitional portion of Regulation D. Rule 502 provides for the integration of certain offerings. The doctrine of integration essentially prevents issuers of securities from avoiding the requirements of Section 5 by breaking offerings into small pieces. Rule 502 lists fives factors to be considered when determining whether a number of offerings should be integrated:

1. Whether the sales are part of a single plan of financing;
2. Whether the sales involve issuance of the same class of securities;
3. Whether the sales have been made at or about the same time;
4. Whether the same type of consideration is being received; and
5. Whether the sales are made for the same general purpose.

In this case, factors three and four are undisputed and point toward requiring integration of the three VesCor securities offerings. The securities were offered simultaneously and the same type of consideration was received from investors of each of the investment vehicles, the Accrual Notes, Monthly Notes and Mortgage Loan Participation Interests.[22]

As for the "class of security" (second factor), two kinds of notes were offered along with an investment contract. Respondents argue that each offering consisted of a separate class of security with different characteristics regarding the timing and amount of returns. While we agree that the offerings are not identical, they do have many similar features. For instance, the PPMs for all three offerings provided the same maximum amount of a non-equity security and incorporated the same investor suitability standards and risk factors. Additionally, investors in

[22] The consideration for each consisted of the rejection of the right to rescind a prior investment, the election to credit accumulated interest to principal and, if a new or additional investment was made, cash.

any of the three programs could elect to invest for 30, 45 or 60 months. Moreover, the PPM for the Mortgage Loan Participation Interests stated that its target return was 12 percent, the Accrual Note rate was 12 percent, and the Monthly Note rate was 10 percent. All three securities also were intended to raise funds necessary for VesCor's holding, making or acquisition of loans.

We note, as well, that the SEC has determined that various investment vehicles that differ "in terms of duration, interest rate and face amount" may nevertheless be characterized as the same "class of securities." Nigh Savings, Inc., No-Action Letter (July 25, 1987). Cf. Madison Park Investment Management, Inc., No-Action Letter (April 4, 1986) (stating that offerings in question may have to be integrated notwithstanding that the proceeds raised in each offering would be used solely to purchase securities for distinct trust portfolios, there would be no commingling of assets of the trusts and there would be no expense sharing). The SEC has also found that integration may be appropriate in situations involving common stock and convertible subordinated debt offerings, and subordinate debt and note offerings. See, e.g., LaserFax, Inc., No-Action Letter (August 15, 1985) (indicating that a good case for integration existed, notwithstanding that the opinion related to common stock and convertible subordinated debt offerings); State St. Mortgage Co., No-Action Letter (Feb. 12, 1987) (stating that integration was proper; involving subordinate debt and note offerings). The fact that the securities in question are of similar character and the investors enjoy similar rights and privileges suggests that these are of the same class of securities. Nonetheless, we cannot say that the "class of security" factor, standing alone, militates for or against integration. Such a determination does not, however, end our inquiry. As the courts have explained, the presence or absence of, or the weight given to, any one of the five factors listed above is not determinative. See SEC v. Cavanagh, 1 F. Supp. 2d 337, 364 (S.D.N.Y.), aff'd, 155 F.3d 129 (2d Cir. 1998). See also SEC v. Murphy, 626 F.2d 633, 645-46 (9th Cir. 1980) (finding that integration of offerings was appropriate where four of the five factors weighed in favor of integration). Whether a number of security offerings should be integrated must be decided based upon the totality of the circumstances.

The two remaining elements -- whether the sales are part of a single plan of financing (factor one) and are made for the same general purpose (factor five) -- indicate that these security offerings should be integrated. The PPMs all provided that VesCor's "principal business objective . . . in offering [the securities was] to invest the proceeds from the sale of such [securities] in loans secured by first Mortgages on real property." Each PPM also stated as follows:

> The Company intends to provide general funding for the operations of the Company's expansion activities with respect to a series of mortgages made or purchased at a discount. The source of such funds would be the proceeds from the sale of [the subject security] and the sale of [the two other securities] pursuant to other simultaneous private offering memoranda.

The "Use of Proceeds" language was substantially similar in each PPM and provided for the application of the investments towards the holding, making or acquisition of loans secured by real estate. As already mentioned, the suitability standards and risk factors for investment were the same for each security, each offered the investor an election of a 30-, 45- or 60-month term, and the stated or target rates of return were close to the same (12 percent for the Mortgage Loan Participation Interests and for the Accrual Notes and 10 percent for the Monthly Notes). Each was also redeemable at VesCor's option.

We find that, taken as a whole, the evidence in this case requires that these offerings be integrated and considered as a single offering for purposes of determining whether they are entitled to exempt status under SEC Rule 506. Only one of the factors, the "class of security," does not clearly weigh in favor of integration. Conversely, the other four factors strongly indicate that integration is appropriate. Of these factors, we find most important that the evidence indicates that these securities were all offered for the same general purpose -- to finance VesCor's mortgage lending and trust deed business -- and were part of a single plan of financing those activities. See Cavanagh, supra, at 364 ("A review of the cases and no-action letters strongly suggests that the 'single plan of financing' and 'same general purpose' factors normally are given greater weight than the 'other factors.'") (citations omitted).[23] Having concluded that the three offerings should be integrated, we also find that, because it is undisputed that there were more than 35 unaccredited investors in the aggregated offerings, the exemption from registration provided by Rule 506 was unavailable. (Indeed, even assuming, arguendo, that integration of the three offerings was not appropriate, the Accrual Note offering would still fail to meet the requirements needed for the Rule 506 exemption because it is undisputed that there were more than 35 unaccredited investors for that offering alone.)

However, even though the VesCor offering failed to meet the requirements of Rule 506, respondents may still attempt to prove that Section 4(2) of the 1933 Act applies to the offering, which exempts from registration "transactions by an issuer not involving any public offering." The seminal case involving the issue of whether an offering is public or private is the United States Supreme Court's decision in SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953). In Ralston, the Court stated that the determination of whether an offering is exempt "should turn on whether the particular class of persons affected needs the protection of the [1933 Act]." Id. at 125. The Court concluded that the company's offering to "key employees" was not exempted because the employees "were not shown to have access to the kind of information which registration would disclose." Id. at 127. Building on the Ralston decision, courts commonly cite four factors as providing useful guidelines for determining whether an offering of securities is public or private: (1) the number of the offerees; (2) the sophistication of the offerees; (3) the size and manner of the offering; and (4) the relationship of the offerees to the issuer. See SEC v. Murphy, 626 F.2d 633, 644-45 (9th Cir. 1980).

Here, there is evidence that at least 102 individuals invested in the VesCor securities. Respondents, however, failed to present evidence of either the exact or approximate number of offerees that were contacted and provided the opportunity to purchase the VesCor securities.

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[23] Courts have found a "single plan of financing" even where invested funds were ultimately allocated toward the purchase of distinct pieces of property. See, e.g., SEC v. Melchior, No. 90-C-1024J, 1993 WL 89141, at *10-11 (D. Utah Jan. 14, 1993); Johnston v. Bumba, 764 F. Supp. 1263, 1272 (N.D. Ill. 1991), aff'd, 983 F.2d 1072 (7th Cir. 1992) (table format).

Thus, there is no way to determine the true scope of the offering. We are left instead only with evidence of the number of individuals who actually purchased VesCor securities from (or were otherwise known to) respondents, a number that is presumably smaller than the actual number of offerees in light of Kunz's testimony that K&C was not the sole selling agent for the securities. As a number of courts have held, the failure of the party claiming the exemption to introduce evidence of the number of offerees may be fatal to his or her claim. See, e.g., Mark v. FSC Secs. Corp., 870 F.2d 331, 334 (6th Cir. 1989) (stating that defendant's failure to show the actual number of offerees may be fatal to its claimed exemption under section 4(2) and noting that the number of offerees was likely far greater than the ultimate 28 purchasers); Murphy, 626 F.2d at 645 (holding that the failure of the party asserting the exemption to introduce evidence on the number of offerees was fatal). In any event, although the total number of offerees involved remains a mystery, we find that 102 actual investors of these securities represents a sufficiently large number of investors to raise doubt as to whether the offering should be considered private under Section 4(2).

The evidence also indicates that many of these investors were not particularly sophisticated with respect to business and financial matters generally and did not have any specific experience in either real-estate or mortgage-loan transactions.[24] Many of the investors were retired and living on fixed incomes when they purchased the VesCor securities. The record indicates that their pre-retirement occupations cut across a broad spectrum, including accountant, auto-parts salesman, heavy-equipment operator, high-school teacher, insurance salesman, librarian, minister, motor vehicle registrar, nurse, U.S. Postal worker, etc. Some investors had college degrees, but many did not. Likewise, some investors had financial or business-related backgrounds, but most did not. In addition, other than the VesCor securities, most investors had previously invested in moderate to conservative investments, e.g., individual retirement accounts, bank certificates of deposit, pension plans, mutual funds, and variable annuities. In fact, the record indicates that a number of investors had not made any recent investments aside from the VesCor securities. In brief, this was not a case primarily involving institutional investors or high-ranking insiders. The general lack of sophistication of the investors provides a substantial basis for finding that the offering was not private.

As to the size and manner of the offering, each PPM for the three programs offered up to $6 million worth of securities priced at $5,000 per unit of investment, for a total of $18 million. Although the dollar amount of this offering may not be a dispositive factor, we find that such an amount is not insignificant. See, e.g., Murphy, 626 F.2d at 646-47 (finding a $7.5 million offering to be sizable and one that should be considered public "absent a significant showing the investors did not need the protection of the Act."). Moreover, the securities were sold by VesCor, K&C, and according to Kunz, by at least one other registered broker/dealer.[25] As courts

[24] We note as well that the investors' lack of sophistication is even more apparent when viewed against the speculative nature of the VesCor securities. VesCor itself described these securities in the PPMs as involving a "high degree of risk" and as being "speculative," statements with which we concur in light of VesCor's history of operating losses, the inherent risks of real estate lending and the illiquidity of the securities.

[25] The parties did not provide significant information regarding this other broker/dealer's role in the offering. As a result, it is unclear how many offerees may have been contacted by this second broker/dealer or whether any such offerees purchased the VesCor securities.

have noted, although it is proper for an issuer to contact offerees through a registered broker/dealer, "that means of contact, depending on its scope and manner, nevertheless may be more indicative of a public, as opposed to private offering." Johnston v. Bumba, 764 F. Supp. 1263, 1274 (N.D. Ill. 1991), aff'd, 983 F.2d 1072 (7th Cir. 1992) (table format); see also Mark, 870 F.2d at 334; Murphy, 626 F.2d at 646.[26] In addition, the evidence indicates that the investors were a fairly diverse, unrelated group who resided in many different communities in a number of different states. See Mark v. FSC Secs. Corp., 870 F.2d 331, 334 (6th Cir. 1989) (noting that the fact that the purchasers were made up of a diverse, unrelated group suggested that the offering was public, not private) (citing Hill York Corp. v. American International Franchises, Inc., 448 F.2d 680, 691 (5th Cir. 1971)). We find that the size and manner of the offering militates against categorizing it as private.

With regard to the final factor, courts have held that a determination that the investors do not need the protection of the 1933 Act may be made only if "all the offerees have relationships with the issuer affording them access to or disclosure of the sort of information about the issuer that registration reveals." Murphy, 626 F.2d at 647. In the current case, the only relationship that the offerees, other than Kunz and Anderson, had with VesCor was that of investors. Such status alone, of course, does not put them in a position to have access to the types of information provided in a registration statement. See, e.g., SEC v. Spence & Green Chemical Co., 612 F.2d 896, 902 (5th Cir. 1980) (holding that the offeree shareholders did not enjoy any "special relationship with the company that allowed them realistic access to the necessary information."), cert. denied, 449 U.S. 1082 (1981); SEC v. Sunbeam Gold Mines Co., 95 F.2d 699, 702 (9th Cir. 1938) (stating that confining an offering to the company's shareholders did not bring it within the private placement exemption).[27] Moreover, there is no evidence that any, let alone all, offerees had direct access to the books and records of VesCor from which they could confirm the representations made in the PPMs. This was not a situation where some special, close relationship existed between the offerees and the issuer. Additionally, there is no evidence indicating that the offerees had the sophistication to know what type of information to ask for and how to evaluate it if provided, much less the economic leverage to demand information. Indeed, even Kunz testified at the DBCC hearing that he was at times denied access by Southwick to VesCor's financials.[28]

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[26] Although many of the investors were previous note holders of VesCor, at least two investors were new purchasers who were contacted by K&C.

[27] Nor does the fact that an investor has had favorable experiences with the issuer and evidences a "continued eagerness to invest . . . supplant his lack of access to the information that a registration statement would show." Lawler v. Gilliam, 569 F.2d 1283, 1290 (4th Cir. 1978).

[28] Nevertheless, on appeal respondents argue that the information disclosed in the PPMs gave investors access to the same information that a registration statement would provide. We disagree. A registration statement would have required VesCor to provide financial results for a longer time frame than the relatively short period included in the PPMs. Significantly, Cline emphasized during his testimony that it was his review of that historical financial data that caused him to conclude that something was fundamentally amiss with VesCor. Moreover, Kunz admitted during the DBCC hearing that the VesCor PPM did not provide the same information as would an ordinary disclosure document.

In light of the above discussion, we find that the VesCor securities were not registered with the SEC and were not exempt from such registration pursuant to either Rule 506 of Regulation D or Section 4(2) of the 1933 Act. As a result, we conclude that respondents violated Conduct Rule 2110 by selling these securities in contravention of Section 5 of the 1933 Act.

Cause Three - Unsuitable Recommendations. The third cause alleged that K&C, through Kunz, made recommendations to purchase VesCor securities that were unsuitable for 30 K&C customers. The DBCC found suitability violations regarding 29 customers.

Conduct Rule 2310 provides that a representative may make only such recommendations as would be consistent with the customer's financial situation and needs. See In re Larry Ira Klein, Exchange Act Rel. No. 37835, at 10 (Oct. 17, 1996). Even where a customer affirmatively seeks to engage in highly speculative or otherwise aggressive trading, a representative is under a duty to refrain from making recommendations that are incompatible with the customer's financial profile. See In re Gordon Scott Venters, 51 S.E.C. 292, 294-95 (1993); In re John M. Reynolds, 50 S.E.C. 805, 809 (1992). This is especially true where a broker/dealer's recommendation leads to a high concentration in the customer's account of a particular security or group of securities that are speculative. See, e.g., In re Clinton Hugh Holland, Exchange Act Rel. No. 37991, at 8 (Dec. 21, 1995), aff'd, 105 F.3d 665 (9th Cir. 1997) (table format).

In this case, we are unable, based on the current record, to uphold the DBCC's determination that respondents violated the NASD's suitability rule. As intimated above, a predicate to finding such a violation is a showing that the respondent recommended the purchase of the securities in question. Here, there simply is no clear evidence that respondents actually recommended the purchase of the VesCor securities within the time frame alleged in the complaint.[29] Accordingly, we reverse and dismiss the third cause of action.

Cause Four - Payments to an Unregistered Person for the Sale of Securities. The fourth cause of the complaint alleged that Kunz compensated Anderson for his solicitation of purchases of VesCor securities on behalf of K&C when Anderson was not registered with the firm. As an initial matter, we observe that "the NASD's registration requirement 'provides an important safeguard in protecting public investors' and, consequently, 'strict adherence' to that requirement is 'essential.'" In re Patricia H. Smith, Exchange Act Rel. No. 35898, at 4 (June 27, 1995) (citations omitted).

In the present case, it is undisputed that Kunz knew that Anderson was not properly registered to offer or sell securities while he worked for K&C. It is also uncontested that Anderson participated in the solicitation and sale of VesCor securities transactions while working for K&C. During the DBCC hearing, moreover, Kunz admitted that he paid Anderson a sum that approximated what Anderson would have been paid had he been eligible to receive commissions

[29] We note that the context within which this offering took place was highly unusual because of the rescission offer that was provided in the PPMs, which was required to be sent to Nevada residents who had previously purchased VesCor securities, pursuant to the consent decree between the State of Nevada and VesCor.

on the VesCor transactions involving his clients. Finally, during the NAC appeal hearing, Kunz's counsel acknowledged that Kunz's payments to Anderson constituted a "clear-cut violation." Under the facts of this case, we find that respondents' payments to Anderson in connection with securities transactions violated Conduct Rule 2110. See In re Michael Brian Kormos, Exchange Act Rel. No. 35823 (June 8, 1995) (finding respondent in violation of Conduct Rule 2110 where he allowed an unregistered person to solicit securities business); In re Gary D. Cohee, 48 S.E.C. 917 (Dec. 17, 1987) (holding that respondent violated the NASD's rules by permitting unregistered person to effect securities transactions and paying certain consulting fees to the unregistered person in relation to such activities).

Sanctions

The DBCC censured K&C and Kunz and fined them $30,000, jointly and severally, for the violations alleged in the first three causes of action (consisting of joint and several fines of $10,000 each for the violations found under causes one, two and three of the complaint). In addition, the DBCC imposed a $5,000 fine on Kunz individually for the violation found under cause four and suspended him from association with any member in any capacity for one month and in a principal capacity for one year. The DBCC also required that Kunz requalify by examination as a representative and as a principal. In addition, the DBCC imposed an independent consultant requirement related to K&C's participation in any public or private offering of securities in the capacities of lead underwriter or primary placement or sales agent. Finally, K&C and Kunz were assessed $2,597.20 in costs, jointly and severally, for the DBCC hearing.

The sanctions we impose today differ slightly from those of the DBCC. We discuss the sanctions imposed for each cause of action separately below. We note as a threshold matter, however, that in determining appropriate sanctions, we have reviewed and considered the NASD Sanction Guidelines and have taken into account all of the relevant facts in this case. We also are mindful of the principle that sanctions may be tailored to impress upon respondents and others in the securities industry the need to comply with the federal securities laws and the NASD's rules, as well as to deter similar misconduct in the future. See In re Daniel Joseph Alderman, Exchange Act Rel. No. 35997, at 7 (July 20, 1995), aff'd, 104 F.3d 285 (9th Cir. 1997).

Cause One - Material Misrepresentations and Omissions. The relevant Sanction Guideline for making material misrepresentations or omissions recommends fining respondents $5,000 to $50,000 and requiring restitution of customer losses. See NASD Sanction Guidelines (1996 ed.) at 34. Where the statements or omissions were negligently made and substantial loss resulted, the Guideline suggests suspending individual respondents for five to 60 business days. Id. The Guideline intimates that a shorter suspension for the firm and a requirement for corrective action may also be appropriate. Id. In addition, the Guideline lists a number of factors that should be considered, including: (1) prior or other similar misconduct; (2) whether the conduct was part of a larger fraudulent scheme, such as a "boiler room" operation; (3) the degree or extent of the false and misleading character of the statements or omissions; (4) the number of misrepresentations or omissions involved; (5) the number of customers involved; (6) the extent of harm or injury to customers; (7) whether the misstatements were made intentionally, recklessly or negligently; (8) whether respondents attempted to verify the information; and (9) other aggravating or mitigating factors. Id.

Here, there is no evidence that respondents have engaged in prior, similar misconduct or that they were part of a larger fraudulent scheme of the kind contemplated by the Guideline. The record is also devoid of any showing that the customers have incurred any losses. Additionally, we have expressly found that respondents acted negligently, not recklessly or intentionally. We view these facts as mitigating.

However, other aspects of this case indicate that there are some aggravating factors present as well. For instance, the misrepresentations and omissions were material and they were made to more than 100 customers. Moreover, respondents did not undertake any investigation, let alone a reasonable investigation, of the representations made in the VesCor PPMs.

After weighing these factors, we order that respondents be censured and fined $10,000, jointly and severally, in relation to the first cause of action. We also order that Kunz be suspended for 15 calendar days in a representative capacity and 15 calendar days in a principal capacity, to run concurrently.

Cause Two- Offering Unregistered Securities to the Public. The relevant Sanction Guideline for selling unregistered securities recommends fining respondents $2,500 to $50,000 plus the amount of any commissions, mark-ups, or profits to respondents. See NASD Sanction Guidelines (1996 ed.) at 57. In cases involving knowing or reckless conduct or repetitive offenses, the adjudicator is to consider a bar or suspending respondents for an appropriate period. Requiring requalification by examination also should be considered. Id. In addition, the Guideline lists a number of factors that should be considered, including: (1) prior or other similar misconduct; (2) whether respondents knew or should have known of the absence of a registration exemption; (3) whether respondents attempted to comply with any exemption from registration; (4) the number of offerings/issues involved; (5) the number of purchasing customers involved; (6) the number, share volume, and dollar amount of transactions involved; (7) profits realized by respondents; (8) additional benefits realized where seller/respondent is owner of the unregistered securities being sold (or affiliated with the owner); (9) rescission offers or subsequent return of customers' funds; (10) demonstrated corrective measures or controls to prevent recurrence; (11) internal discovery and reporting of misconduct; and (12) other aggravating or mitigating factors. Id.

Here, respondents have not engaged in other similar misconduct. Nonetheless, there are a number of factors that we find aggravating. Respondents were aware that each of the three VesCor securities might be sold to more than 35 unaccredited investors, thereby eliminating the Rule 506 exemption. They also should have performed an analysis of whether the three securities needed to be offered as a single offering under the integration doctrine. Moreover, they should have realized that their customers lacked the type of relationship with VesCor that would have enabled the securities to obtain exempt status under Section 4(2). Respondents claim that they truly did not realize that the VesCor securities were not exempt. Although we are inclined to accept their representation as to their state of mind, respondents' ignorance was a product of their own inattentiveness. They never performed an analysis of whether the securities met any of the exemption criteria and they did not seek the advice of independent counsel. The securities laws and NASD rules require much more. Moreover, respondents offered these unregistered, non-exempt securities to more than 100 customers, many of whom purchased them.

In light of the foregoing, we order that respondents be censured and fined $10,000, jointly and severally, in relation to the second cause of action.

Cause Three-Unsuitable Recommendations. Consistent with our determination that there is insufficient evidence to support the DBCC's finding that respondents made unsuitable recommendations to the customers at issue, we eliminate the $10,000 fine that the DBCC imposed on respondents, jointly and severally, as to the third cause of action.

Cause Four - Payments to an Unregistered Person for the Sale of Securities. The relevant Sanction Guideline for registration violations recommends fining respondents $2,500 to $50,000. See NASD Sanction Guidelines (1996 ed.) at 41. In cases where an individual recklessly or knowingly violates (or causes to be violated) the registration requirements, the Guideline recommends suspending respondent for no less than 30 days or a bar. Id. The Guideline also advises that requalification by examination for any principal may be appropriate. Id. In addition, the Guideline lists a number of factors that should be considered, including: (1) prior or other similar misconduct; (2) whether a registration application had been filed (or an application was pending); (3) the length of time functioning while unregistered or improperly registered; (4) knowledge of the registration requirements; (5) frequent or inadvertent use of unregistered persons by the firm; (6) the extent of supervisory procedures in place at the time of the violation to detect and prevent registration deficiencies; (7) whether any corrective action was voluntarily taken by firm upon discovery of problem; (8) the nature and extent of unregistered person's responsibilities; (9) the explanation for failure to properly register; and (10) other mitigating or aggravating factors.

In the present case, we find several aggravating factors. Kunz knew that Anderson was not properly registered and yet he allowed him to offer and sell speculative securities to multiple customers for a number of months. Furthermore, Kunz paid Anderson a sum that approximated the amount Anderson would have been paid had he been eligible to receive commissions. We also strongly disagree with Kunz's argument that his conduct merely constituted a technical violation of the rules. As discussed above, the "requirement that an associated person be registered before engaging in any securities business provides an important safeguard in protecting the public investors." Ashvin Shah, supra, at 8. Kunz's knowing violation of the registration requirements is inexcusable.

Accordingly, we order that Kunz be censured and fined $5,000 in relation to the fourth cause of action. We also suspend him from associating with any member firm in a registered capacity for 15 calendar days and in a principal capacity for 350 calendar days, to run concurrently.

Conclusion

In summary, we find that K&C and Kunz violated Conduct Rule 2110 as alleged in the first cause of action by selling securities pursuant to PPMs that contained material misrepresentations and omissions and, as alleged in the second cause of action, by selling unregistered securities that were not exempt from registration in contravention of Section 5 of the 1933 Act.[30] We also find that Kunz violated Conduct Rule 2110 by compensating an unregistered person in relation to the sale of securities. We reverse and dismiss, however, the DBCC's finding that K&C and Kunz violated Conduct Rules 2110 and 2310 by making unsuitable recommendations to certain customers. In addition, we affirm the DBCC's dismissal of the first cause of action to the extent that it alleged a violation of Conduct Rule 2120.

We impose the following monetary sanctions: K & C and Kunz are fined $20,000, jointly and severally; and Kunz is fined $5,000, individually. Additionally, we uphold the DBCC's imposition of $2,597.20 in hearing costs, joint and several.[31] We also impose non-monetary sanctions on Kunz as follows: Kunz is suspended from associating with any member firm in a representative capacity for a total of 30 calendar days and in a principal capacity for a total of one year, to run concurrently.[32] In relation to the first, second, and fourth causes of action, we further order that Kunz requalify by examination as a representative within 90 days of the conclusion of his suspension as representative or cease to function in any representative capacity until he so requalifies and that he requalify as a principal before functioning in such a capacity.

Finally, we order that -- in relation to the first and second causes of action -- K&C be suspended from participation in any public or private offering of a security in the capacities of

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[30] Respondents filed a motion after the appeal hearing in this matter requesting that a letter from the SEC to VesCor, dated March 10, 1999, be added to the record. The SEC's letter to VesCor states as follows:

> This is to advise you that the staff inquiry in the above-captioned matter [In re VesCor Capital Corporation] has been terminated and that, at this time, no further enforcement recommendation is anticipated. The fact that the inquiry has been terminated should not be construed as an indication that any party has been exonerated. Additionally, as with any terminated inquiry or investigation, the inquiry could resume although the staff, at present, does not intend to make further recommendations.

We have included the letter in the record. However, the existence of this letter does not, in any manner, alter our findings. Nothing in the SEC's letter clearly indicates that the inquiry referenced in that letter relates to the activities at the heart of the instant case and none of the parties to the current action are referenced in the SEC's letter. Moreover, even if the SEC's inquiry related to the offering in question, the SEC's letter expressly states that the "fact that the inquiry has been terminated should not be construed as an indication that any party has been exonerated." In addition, there are any number of reasons why the SEC might have decided against pursuing the matter further as to VesCor.

[31] We have not required respondents to make restitution to any customers because there was no showing of any customer losses. We also have not fined respondents any amount representing commissions or profits because the record does not provided a sufficient basis for making such determinations.

[32] The suspensions shall begin 30 days after the date of this decision.

lead underwriter or primary placement or sales agent until such time as: (a) it retains an independent consultant acceptable to NASD Regulation District No. 3 staff to review the adequacy and completeness of the firm's operational, compliance and supervisory procedures pertaining to participation in such offerings in such capacities; (b) the independent consultant issues a report to the Firm, with a copy to District No. 3 staff, setting forth his or her recommendations for changes and/or additions to such procedures in order to further compliance with all applicable laws, rules and regulations related to the securities industry; and (c) the Firm implements, and demonstrates to District No. 3 staff that it has implemented, the recommendations of the consultant. For two years from the date on which K&C receives notice from District No. 3 staff that it has complied with the independent consultant provisions listed above, K&C shall be required to retain independent counsel to review all offering documentation prepared for use in connection with any offering of securities in which it participates in the capacities of lead underwriter or primary sales or placement agent.[33]

On Behalf of the National Adjudicatory Council,

Joan C. Conley
Senior Vice President and Corporate Secretary

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[33] We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Pursuant to NASD Procedural Rule 8320, any member who fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.