SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 64852 / July 11, 2011

Admin. Proc. File No. 3-14015

In the Matter of the Application of

FCS SECURITIES
and
DALE EDWARD KLEINSER
417 E. 90th Street Suite 8C
New York, NY 10128-5175

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDINGS

Failure to File Audited Annual Reports

Registered securities firm, acting by and through its sole proprietor, failed to file audited annual reports for fiscal years 2006 and 2007, in violation of Section 17(e) of the Securities Exchange Act of 1934, Exchange Act Rule 17a-5, and NASD Rule 2110. *Held*, association's findings of violations and sanctions imposed are *sustained*.

APPEARANCES:

Dale Edward Kleinser, *pro se* and for FCS Securities.

Marc Menchel, Alan Lawhead, and *Leavy Mathews III*, for FINRA.

Appeal filed: August 20, 2010
Last brief received: December 10, 2010

I.

Dale Edward Kleinser and FCS Securities ("FCS" or the "Firm"), of which Kleinser is the sole proprietor (together, "Applicants"), appeal from disciplinary action taken by the Financial Industry Regulatory Association ("FINRA").[1] FINRA found that FCS, by and through Kleinser, failed to file audited annual reports for fiscal years 2006 and 2007, in violation of Section 17(e) of the Securities Exchange Act of 1934, Exchange Act Rule 17a-5, and NASD Rule 2110.[2] FINRA additionally found that Applicants failed to establish that they were relieved of the obligation to file audited financial statements by virtue of the exemption contained in Exchange Act Rule 17a-5(e)(1)(i)(B) (the "Exemption"), which permits a broker or dealer to file unaudited financial statements if "[i]ts securities business has been limited to buying and selling evidences of indebtedness secured by mortgage, deed or trust, or other lien upon real estate or leasehold interests."[3] FINRA fined Applicants $5,000 and suspended FCS for four months; it further ordered that the suspension would convert to an expulsion from membership if FCS did not file audited annual reports for 2006 and 2007 during the four months of the suspension.[4] We base our findings on an independent review of the record.

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[1] Following the consolidation of NASD and the member regulation, enforcement, and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See FINRA Regulatory Notice* 08-57 (Oct. 2008). Because the complaint in this case was filed before December 15, 2008, FINRA applied the procedural rules that existed on December 14, 2008. The applicable conduct rules are those that existed at the time of the conduct at issue.

[2] Section 17(e), 15 U.S.C. § 78q(e), and Rule 17a-5(d), 17 C.F.R. § 240.17a-5(d), require registered brokers and dealers to file audited financial information with the Commission on an annual basis unless an exemption applies. NASD Conduct Rule 2110 requires NASD members to observe high standards of commercial honor and just and equitable principles of trade. A violation of any Exchange Act rule also constitutes a violation of Conduct Rule 2110. *See, e.g., Paul Joseph Benz*, 58 S.E.C. 34, 41 n.15 (2005) (holding that a violation of the net capital rule, Exchange Act Rule 15c3-1, 17 C.F.R. § 240.15c3-1, is also a violation of Conduct Rule 2110); *see also, e.g., William M. Gerhauser, Sr.*, 53 S.E.C. 933, 942 (1998) ("We have consistently maintained that a violation of another SEC . . . rule or regulation constitutes a violation of the requirement to adhere to 'just and equitable principles of trade' embodied in the NASD Rules of Fair Practice . . . .").

[3] 17 C.F.R. § 240.17a-5(e)(1)(i)(B).

[4] FINRA also ordered Applicants to pay costs. Pursuant to Procedural Rule 9370, the sanctions were automatically stayed when Applicants filed their petition for review with the Commission.

II.

A. Background

Kleinser entered the securities industry in 1986. In 1997, he formed FCS as a sole proprietorship. At all relevant times, Kleinser was FCS's sole owner, and was registered as a financial and operations principal, general securities representative, and general securities principal. Kleinser was also, at all relevant times, the sole officer, sole director, and sole common shareholder of FCS Ventures, Inc. ("Ventures"), which he also controlled. Ventures has approximately twelve preferred shareholders, among whom are Kleinser's sister and his parents. Ventures is not a member firm.

Kleinser originally intended to engage in proprietary principal trading through FCS. When he applied for FINRA membership for the Firm, however, the Firm did not have enough capital to trade on a proprietary basis; so, in April, 1997, he signed a membership agreement that limited FCS's operations to investment advisory services, an arrangement not hindered by the Firm's level of capital.[5] FCS has remained a FINRA member since 1997, although it has conducted little if any securities business during that time.[6]

B. FCS's Filings of Financial Information, 2000-2005

Exchange Act Section 17(e) requires registered brokers and dealers to file audited financial information with the Commission on an annual basis unless an exemption applies. For fiscal years 2000-2003 inclusive, FCS filed unaudited annual reports. Kleinser testified that FCS filed an unaudited annual report for fiscal year 2000 because the accountant he had engaged failed to complete an audit as agreed. For fiscal years 2001-2003, Kleinser testified that he filed unaudited annual reports in reliance on the Exemption.

After a routine examination of FCS in 2004, FINRA staff determined that FCS did not qualify for the Exemption and issued FCS a letter of caution, dated January 11, 2005, for FCS's failure to file audited annual reports for fiscal years 2000-2003. Kleinser wanted to continue

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[5] Applicants appear to complain about the limitations of the 1997 membership agreement. However, that agreement is not at issue in this proceeding.

[6] Under Article III, Section 1(a) of FINRA's By-Laws, registered brokers or dealers "authorized to transact, and whose regular course of business consists in actually transacting, any branch of the investment banking or securities business in the United States," are eligible for membership in FINRA. In 2004, NASD staff issued a notice of intention to suspend FCS's membership "based on [FCS's] failure to meet the standards for eligibility to be an NASD member set forth in . . . the NASD By-Laws, *i.e.*, failure to engage in an investment banking or securities business." However, the notice was subsequently withdrawn based on "new information and certain representations made by" FCS.

filing unaudited reports, and repeatedly sought the guidance of FINRA staff as to how FCS could qualify for the Exemption. In February 2006, FINRA staff arranged a conference call among Kleinser, FINRA staff members, and a Commission staff member to discuss whether FCS could file annual reports in reliance on the Exemption. Both FINRA staff and Commission staff opined that FCS had not shown that it qualified for the Exemption. Kleinser disagreed, but nonetheless filed an audited annual report on behalf of FCS for fiscal year 2005.

C. FCS's Filings of Financial Information, 2006-07

Despite his filing of the audited annual report for fiscal year 2005, Kleinser still hoped to take advantage of the Exemption so as to avoid having to file audited annual reports in future years. In an attempt to structure the Firm's activities to bring the Firm within the Exemption, Kleinser prepared a series of documents in 2006 and 2007 pertaining to a debt identified in a promissory note dated April 16, 2001 (the "2001 Note"). In Kleinser's view, the transactions described in the 2006 and 2007 documents demonstrate that FCS limited its business to "buying and selling evidences of indebtedness secured by mortgage, deed or trust, or other lien upon real estate or leasehold interests," thus qualifying for the Exemption.

The 2001 Note evidences a loan in the amount of $185,398, with annual interest of 9%, from Ventures to Kleinser's sister and brother-in-law (the "Borrowers"). Before the Hearing Panel, Kleinser confirmed that "Ventures was the one that gave the money to Borrowers." Kleinser testified that the Borrowers used the loan proceeds to buy a home (the "Home"), and the 2001 Note recites that it was secured by the Home. The 2001 Note required the Borrowers to make monthly payments of $1300 until "as late as September 2002" and $1500 thereafter,[7] and provided that in the event of a default, Ventures could elect to sell the Home and apply the proceeds to satisfy the Note. Financing statements pursuant to the Uniform Commercial Code ("UCC Financing Statements") filed with the Ohio Secretary of State list the Borrowers as debtors, Ventures as the secured party, and the Home as the property covered by the statement.[8] Kleinser claims that, at some point between the execution of the 2001 Note and 2006, the Borrowers fell behind on their payments.[9]

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[7] The 2001 Note refers to a payment schedule set forth in a spreadsheet which is not included in the record.

[8] UCC Financing Statements covering the Home were filed on January 2, 2001 and March 29, 2006 (nine months before the First "Buy-Sell" Agreement discussed below). Although the first promissory note in the record is dated April 16, 2001, Kleinser testified that Ventures loaned the money to Borrowers in "2000 or 2001."

[9] The record does not establish how much had been paid on the 2001 Note by 2006. Kleinser testified that there were "no payments at all" on the 2001 Note for "a couple of years or a substantial period of time."

1. Activity in Fiscal Year 2006

Kleinser testified that he wanted to "get that note off the books from a risk standpoint of FCS Ventures and the other FCS shareholders." Kleinser also said he thought that, if he involved the Firm in selling the 2001 Note, he could satisfy the Exemption and be relieved of the obligation to file audited financial statements. Kleinser further testified that he thought the 2001 Note should be "restructured" to make it more likely that the Borrowers would pay it off, and Kleinser thought the "restructuring" could be more easily accomplished if payments were owed to an entity that involved fewer people than Ventures. Accordingly, it was decided that the 2001 Note should be sold.[10]

Kleinser wrote to an NASD staff member on November 26, 2006, stating that the 2001 Note "requir[ed] a title change in 2006" and that "[t]he title change, buy and sell, has not yet taken place per my desire to give you every opportunity to review such pursuant to my intent to adhere to the [E]xemption rule." The NASD staff member responded by letter dated December 12, 2006 that, based on Kleinser's representations, "it would appear that . . . [the title change] . . . may not occur or will only occur if the event would permit FCS to qualify for the [Exemption]." The letter also stated that "the 2005 and 2006 activities of FCS are fairly similar," and that Kleinser had been informed that:

> [I]t was the view of the staff that the proposed conduct of FCS does not qualify for the [E]xemption. The [E]xemption was not intended to permit a firm that is otherwise dormant to not provide audited financial statements, and yet to somehow appear to engage in a 'securities business' in order to maintain on-going registration with the SEC. . . . We continue to be of the view that a re-titling of a promissory note between your affiliate and the obligor, whether or not facilitated by FCS, does not rise to the level of activity as described in the [E]xemption. Nor would acting as facilitator in such regard qualify FCS for NASD membership.

Undeterred by this response, Kleinser wrote to NASD staff on December 26, 2006: "I am not asking for a yes or no – do I qualify. I am asking how do I qualify for this [E]xemption." Kleinser objected that the staff's December 12 letter rejected the use of "re-titling" as a basis for claiming the Exemption, but "overlooks essentials stated by me: buy and sell."

On December 27, 2006, Kleinser individually signed a document that purported to involve purchases and sales related to the 2001 Note (the "First 'Buy-Sell' Agreement").[11] The First "Buy-Sell" Agreement recites that Ventures "hereby buys," and Kleinser's parents (the

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[10] Kleinser does not make clear who was involved in reaching this decision. As FINRA observed, "[m]uch of Kleinser's testimony and supporting documentation lacked specificity."

[11] The First "Buy-Sell" Agreement made no reference to a title change.

"Parents") "hereby sell," "all interest" in the 2001 Note, and further, that Kleinser and Kathy Keller (whom Kleinser identified as a family friend), "hereby buy," and Ventures "hereby sells, same." The First "Buy-Sell" Agreement also stated that "[p]ayment is a $185398 transfer in account 6032241" to the Parents, "which they can do with as they see fit without any restriction."[12]

The record does not show that Ventures endorsed the 2001 Note to Kleinser and Keller, purportedly the new holders. Nor does it show that Kleinser and Keller paid, or Ventures paid or received, any consideration in the purported transaction. The record does not show any payments on the 2001 Note after December 2006.

The First "Buy-Sell" Agreement also stated that "FCS Securities earned $2000 from FCS Ventures and/or [its] shareholders for this activity," without further elaboration. FCS's unaudited annual report for fiscal year 2006 shows that FCS's only income was $315 in interest income, and that it had no income attributable to investment advisory fees. In testimony and correspondence, Kleinser represented that he signed a $345 check to FCS from Ventures for FCS's involvement in the 2006 activities discussed above on December 31, 2006;[13] that an additional $1655 had been promised, but not received, by the end of 2006; and that he reported only the $315 in interest income because it was "the only income received with certainty in 2006."

Kleinser testified that he brokered the sale of the 2001 Note in his capacity as sole owner and principal of FCS. He does not allege that FCS held any interest in the 2001 Note at any time. Other than its involvement in the alleged sale of the 2001 Note, FCS conducted no business activity in fiscal 2006.

2. Activity in Fiscal Year 2007

There is no evidence in the record of any further activity by FCS until December 2007.[14] Kleinser testified that he turned his attention to "restructuring" the loan evidenced by the 2001 Note in order to reach "terms that the [Borrowers] could somehow live with." However, the newly "restructured" note, executed on December 29, 2007 (the "2007 Note"; together with the 2001 Note, the "Notes"), included terms that were virtually identical to those of the 2001 Note: like the 2001 Note, the 2007 Note evidences a loan in the amount of $185,398, with annual interest of 9%, from Ventures to the Borrowers, secured by the Home. The only change from the 2001 Note that arguably made it more likely that the Borrowers would pay off the 2007 Note was

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[12] The record does not include a UCC Financing Statement for this transaction.

[13] This check is not in the record.

[14] On January 12, 2007, Kleinser wrote to an NASD senior vice president, asking again, "HOW DO I QUALIFY FOR THE EXEMPTION?" (emphasis in original). He received no response.

the addition of a provision whereby the Borrowers agreed "to limit any increase in debt, unrelated in any way to this Promissory Note, to $8,000."[15]

Kleinser testified that once the 2001 Note had been "restructured," "the [Ventures] shareholders wanted to attempt to do the right thing and take some of the burden and so they decided that they wanted to try and buy back this thing that was restructured to get [Borrowers] the best chance of getting out of this in one piece." To this end, Kleinser testified, and in hopes of bringing FCS's business for fiscal year 2007 within the Exemption, Kleinser prepared a document dated December 30, 2007 (the "Second 'Buy-Sell' Agreement"; together with the First "Buy-Sell" Agreement, the "'Buy-Sell' Agreements"), which recited that Kleinser and Keller were selling, and Ventures was buying, "all interest in" the 2007 Note, and that Ventures was selling, and the Parents were buying, that interest.[16] The Second "Buy-Sell" Agreement also stated that payment was in the form of a transfer of $185,398 in the same account specified in the First "Buy-Sell" Agreement "from [the Parents] without any restriction," and that FCS "received $1655.00 from [Ventures] and/or [its] shareholders for this activity."[17] FCS's financial statements for fiscal year 2007 indicate that FCS received $2,000 in investment advisory fees.[18]

The record does not show that Ventures endorsed the 2007 Note to the Parents, purportedly the new holders. Nor does it show that Ventures paid or received, or Kleinser and Keller received, any consideration in the purported transaction. The record does not show that Borrowers made any payments on the 2007 Note.

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[15] Kleinser testified that the Borrowers' non-payment problems appeared to be exacerbated by their incurring additional debt unrelated to the 2001 Note. Kleinser further testified that the 2007 Note differed from the 2001 Note in that "the whole payment schedule changed." However, neither payment schedule is included in the record.

Although it appears that the 2007 Note was intended to supercede the 2001 Note, the 2007 Note does not mention the 2001 Note. From the face of the documents, it would appear that the obligations under the 2001 Note are still in effect.

[16] It is not clear from the record what, if any, interest Kleinser and Keller had in the 2007 Note. Kleinser and Keller were not named anywhere in the 2007 Note.

[17] In testimony and correspondence, Kleinser represented that he signed a check for $1655 to FCS, on behalf of Ventures, on December 31, 2007. This check is not in the record. The relationship between this $1655 and the $1655 that was allegedly promised to FCS in 2006, but not received in that year, is unclear.

[18] The $2,000 in investment advisory fees reported for fiscal year 2007 apparently includes the $345 check that was allegedly received on December 31, 2006, but not deposited until 2007, plus the $1655 check that was allegedly written on December 31, 2007. *See supra* notes 13 & 17 and accompanying text.

Kleinser does not allege that FCS held any interest in the 2007 Note at any time. Other than its involvement in the alleged sale of the 2007 Note, FCS conducted no business activity in fiscal 2007.

III.

On July 25, 2008, FINRA's Department of Enforcement ("Enforcement") filed a complaint charging that FCS violated Exchange Act Section 17(e), Exchange Act Rule 17a-5, and NASD Rule 2110, and that Kleinser violated NASD Rule 2110, based on the failure to file audited annual reports for 2006 and 2007. After a hearing, the Hearing Panel found the violations as charged. The Hearing Panel fined Applicants $5,000, jointly and severally, and ordered that FCS be suspended for four months, with the suspension to convert to an expulsion if Applicants did not file audited annual reports for 2006 and 2007 before the suspension ended. Applicants appealed, and FINRA's National Adjudicatory Council affirmed the Hearing Panel's findings of violations and sanctions. This appeal followed.

IV.

A. Analysis of the Exemption

Applicants admit that FCS did not file audited annual reports for fiscal years 2006 and 2007. Thus, the question in this proceeding is whether Applicants established that they were exempt from the requirement to file such reports because the securities business of FCS was "limited to buying and selling evidences of indebtedness secured by mortgage, deed or trust, or other lien upon real estate or leasehold interests."[19] Applicants bore the burden of establishing that they were entitled to the Exemption.[20] We find that Applicants did not establish that they were entitled to the protection of the Exemption.

In the first place, Applicants did not establish that anything was bought or sold. With respect to the First "Buy-Sell" Agreement, no evidence in the record establishes that the Parents

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[19] The Exemption also states that a broker or dealer may not file unaudited financial statements if it has carried any margin account, credit balance or security for any securities customer. FINRA does not contend, and the record does not show, that the Firm failed to satisfy this aspect of the Exemption.

[20] *See generally FTC v. Morton Salt Co.*, 334 U.S. 37, 44-45 (1948) (recognizing that "the general rule of statutory construction [is] that the burden of proving justification or exemption under a special exception to the prohibitions of a statute generally rests on one who claims its benefits"); *cf. SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953) (acknowledging "the broadly remedial purposes of federal securities legislation" in holding that the burden of proof lies with an issuer when it claims an exemption from registration under the Securities Act of 1933).

owned any interest in the 2001 Note that they could sell to anyone, much less to Ventures, which already owned the note. The 2001 UCC Financing Statement confirms Ventures as the secured party. Ventures theoretically could have sold to Kleinser and Keller, but the only suggestion in the record of any consideration given in connection with the First "Buy-Sell" Agreement is the recitation in that Agreement that the Parents, who did not own the 2001 Note and therefore could not have sold it, received $185,398. As noted, there is nothing in the record indicating that any such transfer of funds actually occurred. We conclude that the transactions purportedly effected by the First "Buy-Sell" Agreement lacked any economic reality.

As for the Second "Buy-Sell" Agreement, since there is nothing in the First "Buy-Sell" Agreement supporting a valid sale to Kleinser and Keller, both their purported sale back to Ventures and the ensuing sale from Ventures to the Parents are similarly sham transactions. Moreover, although the Second "Buy-Sell" Agreement references a payment from the Parents, it does not say to whom the payment was made, and there is no record of any such payment.

Applicants' efforts to explain the transactions are not supported by the record. For example, Kleinser testified that, with respect to the First "Buy-Sell" Agreement, the Parents stepped in to act on behalf of Ventures in order to avoid any conflict of interest that might have arisen if Kleinser had both acted on behalf of Ventures and participated in the sale as a buyer. No documentary record evidence shows that the Parents, who were two of Ventures's twelve preferred shareholders, had the authority to act on behalf of Ventures. Nor does the First "Buy-Sell" Agreement say that the Parents are acting on behalf of Ventures. In fact, it says they are selling to Ventures. In any event, such involvement by the Parents would not have eliminated any such conflict of interest, because Kleinser was still a controlling person of Ventures when Ventures "sold" to Kleinser and Keller. Finally, the results ostensibly created by the First "Buy-Sell" Agreement make no sense: the Parents purportedly end up with the $185,398 and Kleinser and Keller are purportedly given the right to collect on the Note, while Ventures arguably retains the secured interest in the Home.

Kleinser argued before FINRA's National Adjudication Committee ("NAC") that Ventures could not have loaned the Borrowers the money because its money was tied up in litigation. That assertion, however, is contradicted by the Notes, the UCC Financing Statements identifying Ventures as the secured party, and Kleinser's testimony before the Hearing Panel that Ventures loaned the Borrowers the money. Additionally, if Ventures's money were tied up in litigation, there would be no apparent way for Ventures to have "bought" the interests (from the Parents in 2006 or Kleinser and Keller in 2007) before turning around and "selling" them (to Kleinser and Keller in 2006 or the Parents in 2007).

Kleinser also argued that the term "FCS Ventures, Inc." in the "Buy-Sell" Agreements did not indicate that Ventures was acting as a corporate entity, but rather that Ventures shareholders,

maintaining separate "accounts" at Ventures, were buying and selling separately held interests.[21] This claim is inconsistent with the references to "FCS Ventures, Inc." in the Notes and the UCC Financing Statements; it is also inconsistent with the nature of a corporation, which acts as a single "person."[22] Moreover, no documentary evidence shows that the Ventures shareholders held separate transferable interests in the Notes.[23]

Applicants argue that they provided "prima facie proof" of "buy and sell activity" (the "Buy-Sell" Agreements), "promissory notes" (the Notes), and "secured debt records" (the UCC Financing Statements). They argue that this alleged proof "is what [the Exemption] requires and . . . is what [Applicants] demonstrated." We disagree. As discussed above, the evidence provided by Applicants does not show that any transactions of economic substance occurred.

Moreover, even if we concluded that the "Buy-Sell" Agreements reflected genuine sales and purchases, FCS was not a party to either of the Notes or either of the "Buy-Sell"

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[21] Before the NAC, Kleinser stated that the Parents "were basically the signers because they were in the majority. There's like, as a guess, ten accounts involved." No documentary record evidence shows that such individual accounts existed, that the Parents "were in the majority," or that the Parents had the authority to act on behalf of Ventures's preferred shareholders.

[22] *See, e.g.*, Ballantine's Law Dictionary, 3d edition 2010 (defining "corporation" as, in part, "an association of persons to whom the sovereign has offered a franchise to become an artificial juridical person, with a name of its own, under which they can act and contract and sue and be sued.")

[23] Applicants appear to be arguing that the use of such phrases as "FCS Ventures and/or its shareholders" in the "Buy-Sell" Agreements show that the shareholders can act independently from the corporate entity. However, the Notes unambiguously identify "FCS Ventures, Inc." as the holder and do not contain any references to Ventures shareholders. Moreover, Applicants state in their brief that "FCS Ventures Inc is the PROMISSORY NOTE HOLDER" (emphasis in original).

Applicants assert in their briefs that "[t]he relevant parties signed per FCS Ventures normal protocol," that "FCS Ventures is 'pledgee' per shareholder agreement", and that "[s]hareholders retain full legal and beneficial ownership." The record does not contain any evidence as to Ventures's "normal protocol," or the shareholder agreement. *See infra* notes 31-35 and accompanying text (denying motion to adduce new evidence on appeal).

Under these circumstances, we find that Applicants failed to establish that the preferred shareholders of Ventures had separately transferable interests in the Notes.

Agreements,[24] and there is no suggestion that FCS bought or sold any instrument. Any notion that FCS was somehow involved in brokering the purported transactions is inconsistent with the membership agreement that has been in effect since 1997, which limits FCS's activity to the provision of investment advisory services.[25]

Applicants argue that they should be permitted to file unaudited financial statements because, in a situation involving what they characterize as "previous activity virtually identical" to theirs, a person received no-action letters stating that the staff would not recommend that the Commission take action based on the filing of unaudited financial statements.[26] Because their

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[24] Kleinser signed the "Buy-Sell" Agreements as an individual, not on behalf of FCS.

[25] *Compare* Exchange Act Section 3(a)(4)(A) (defining "broker" as "any person engaged in the business of effecting transactions in securities for the account of others").

FINRA found that Applicants "presented no evidence that FCS's 'securities business' consisted of buying and selling evidences of indebtedness" as set forth in the Exemption. FINRA found that the Notes were not securities (citing *Reves v. Ernst & Young*, 494 U.S. 56, 65 (1990) (holding that "'the note secured by a mortgage on a home'" is not a security (citation omitted)), and it questioned whether the level of activity in which FCS engaged was sufficient to constitute the level of "business" contemplated by the Exemption. *See* Louis Loss & Joel Seligman, *Securities Regulation* 3009 (3d ed. 2002) (suggesting that the phrase "engaged in the business," which is common to the definition of broker and dealer, "connotes a certain regularity of participation in purchasing and selling activities rather than a few isolated transactions). Because we dispose of the matter on the grounds set forth above, we do not reach these issues.

[26] Applicants base their contention that the circumstances are virtually identical in part on telephone conversations that Kleinser claims he had with the requester. However, Kleinser's testimony about what the requester allegedly told him about his activities is extremely limited. Kleinser testified that "[the requester's] business . . . involved nothing more than having . . . some old lady sell her house, give a note to somebody, money exchanged hands and [the requester] bought and sold that note from a woman that had the note and gave away the house to one of his buddies, literally."

While we have held that hearsay evidence, such as Kleinser's testimony about what the requester told him, may be admitted in administrative proceedings, such evidence must be probative and reliable. *See, e.g., Scott Epstein*, Exchange Act Rel. No. 59328 (Jan. 30, 2009), 95 SEC Docket 13833, 13853. We find, however, that Kleinser's testimony about the requester's business has little if any probative value. Despite Applicants' conclusory assertions, the testimony does not establish that Kleinser's circumstances were virtually identical, or even

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situation is similar, Applicants argue, they should also be permitted to file unaudited financial statements without repercussions.

No-action letters express the views of Commission staff. They do not constitute Commission precedent, nor do they limit subsequent Commission action.[27] We are not bound by the statements of Commission staff in the letters on which Applicants rely. Moreover, the cited no-action letters do not support Applicants' assertions. The requester stated: "My entire business during [the applicable year] was limited to buying and selling land contracts and mortgages (evidences of indebtedness) secured by mortgage, deed, or trust, or other lien upon real estate or leasehold interest." The requester thus repeated the language of the Exemption, without providing further details about the enumerated activities.[28] Four of the no-action letters simply state, tautologically, that "if [the requester's] activities fall within the purview of the (e)(1)(i) exemption, the [staff] will not recommend any action to the Commission" based on the filing of unaudited annual reports. The fifth states that, "[b]ased on the representations" made about the requester's activities (representations that, as noted, simply repeated the language of the Exemption), it would appear that they come within the Exemption. Given the dearth of information about the requester's activities, the no-action letters provide no basis for comparison with the facts at issue here.

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[26] (...continued)
similar, to the requester's. Additionally, Kleinser does not assert, and the record does not show, that Commission staff, in writing the no-action letters, had any information about the requester's activities beyond statements tracking the language of the exemption, as discussed below.

[27] *Cf. Lowell Listrom*, 50 S.E.C. 883, 886 n.3 (1992) (noting that letter sent by Division of Enforcement to New York Stock Exchange and NASD "does not necessarily reflect the views of this Commission, nor does it have the force of law . . . . The Commission may choose to adopt or reject the staff's previously-stated reasoning with respect to the application of the particular regulation at issue, or the necessity of adherence to any particular conditions placed by the staff on the conduct of persons receiving no-action positions."); *see also George C. Salloum*, 52 S.E.C. 208, 212 n.18 (1995) (admitting into the record an internal memorandum prepared by Commission staff, but noting "that it merely expresses the views of our staff, to which we are not bound").

[28] The requester did, however, state that "I have no margin account, securities, or credit balance for my customers. I do not have any agreements with any other Brokers or Dealers concerning my securities business." This language tracks other requirements for the Exemption that are not at issue in this proceeding. *See supra* note 19.

B. Applicants' Procedural Arguments

1. Objections to FINRA Staff Conduct

Applicants argue that FINRA has been "playing games" and engaging in "underhanded tactics" and that FINRA is "actively impeding FCS" and is "not neutral." They complain that FINRA staff failed to tell Kleinser in precise detail how to structure FCS's activities so as to come within the terms of the Exemption.[29]

It was Applicants' responsibility to comply with Section 17(e) and Rule 17a-5, either by filing audited annual reports or by showing that they were not required to do so. We have repeatedly held that members of self-regulatory organizations and their associated persons cannot shift their responsibility for compliance to those organizations.[30] We reject Applicants' attempt to blame FINRA staff for Applicants' statutory and regulatory violations.

2. Introduction of New Evidence on Appeal

Applicants seek to introduce additional evidence on appeal. This evidence, they argue, supports their contention that the preferred shareholders of Ventures could engage independently or collectively in transactions using separately identifiable assets held at Ventures.[31] Establishing

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[29] Applicants also complain of other alleged misconduct unrelated to the failure to file audited annual reports that is the sole issue in this proceeding (for example, that NASD "forced [Kleinser] to apply for a B/D earlier than I would have otherwise").

[30] *See, e.g., Leslie A. Arouh*, Exchange Act Rel. No. 62898 (Sept. 13, 2010), 99 S.E.C. Docket 32306, 32329 n.73 (citing additional cases); *see also, e.g., Frank L. Palumbo*, 52 S.E.C. 467, 478 n.60 (1995) (rejecting argument that applicants should not be sanctioned for markup violations because they "approached the NASD staff on a number of occasions for guidance as to a working definition of domination and control, and were rebuffed on each occasion"); *G.K. Scott & Co.*, 51 S.E.C. 961, 966 n.21 (1994) (rejecting contention that applicants should not be sanctioned for markup violations where applicants asserted "that the firm routinely passed numerous markup exam reviews and that at no time was the firm's practice of determining the prevailing market price questioned"), *petition denied*, 56 F.3d 1531 (D.C. Cir. 1995).

[31] Applicants' Motion to Adduce Additional Evidence (the "Additional Evidence Motion") does not identify with particularity the evidence Applicants seek to adduce. Instead, it cross-references filings made before FINRA in furtherance of Applicants' motion to adduce additional evidence after the hearing (the "Post-Hearing Evidence Motion").

As best we can tell from the Additional Evidence Motion, the only point Applicants now

(continued...)

this point would, they argue, support their argument that the purported "buy-sell" transactions were legitimate business undertakings. Applicants sought to adduce this evidence after the hearing, when the matter was under review by the NAC, but the motion was denied.[32]

Our Rule of Practice 452 provides that a party seeking to adduce additional evidence must "show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously."[33] We find that Applicants have not met this standard.

First, Applicants have not shown that there were reasonable grounds for their failure to adduce the evidence previously.[34] Applicants bore the burden of establishing their entitlement to the Exemption. To succeed, they needed to introduce evidence sufficient to show that the purported transactions on which they relied were actual transactions, with economic substance, and that those transactions qualified the Firm for the Exemption. If additional evidence pertaining to the structure of Ventures would have helped to make this showing, Applicants should have introduced it during the hearing as part of their affirmative case.

Applicants contend that, until closing argument, they had no reason to foresee that Enforcement would argue that the transactions at issue were shams and that they therefore had no

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[31] (...continued)
hope to make with newly adduced evidence is that the preferred shareholders of Ventures could engage in separate transactions with the assets they had invested in Ventures. Because Applicants do not press arguments pertaining to other evidence FINRA refused to allow after the hearing, we deem those arguments abandoned. We have, however, reviewed FINRA's denial of the Post-Hearing Evidence Motion, and we see no error in FINRA's disposition of that motion.

[32] The record does not contain copies of the evidence about Ventures that Applicants sought to adduce in the Post-Hearing Evidence Motion. Applicants contended that providing the evidence would disclose information about third parties (Ventures shareholders) that those parties did not want disclosed. Applicants therefore provided only descriptions and characterizations of the evidence. We are thus unable to determine whether the evidence, if timely submitted, would have supported Applicants' assertions.

[33] 17 C.F.R. § 201.452. Similarly, FINRA Procedural Rule 9346 permits the introduction of additional evidence before the NAC upon a showing that "extraordinary circumstances" exist, that the evidence is material to the proceeding, and that there was good cause for failing to introduce it below.

[34] Although, as subsequently discussed, we find that Applicants did not show the proposed additional evidence to be material, our finding that Applicants did not show reasonable grounds for failing to adduce the evidence previously is itself a sufficient basis for our denial of the Additional Evidence Motion.

reason to introduce at the hearing evidence showing that Ventures shareholders could buy and sell separately held interests through separate accounts they maintained at Ventures. They contend that they were prepared to explain FCS's business during the years 2006 and 2007, but had "no warning" that they would need to provide evidence about earlier activity, such as documents setting forth details of Ventures's relationship with its shareholders.

We disagree. Applicants consistently based their argument that they were entitled to rely on the Exemption on only two purported transactions. Applicants knew that FINRA staff did not agree that this activity allowed Applicants to utilize the exemption, even if the staff had not previously characterized the transactions as a sham. Under these circumstances, Applicants should have foreseen that these transactions would be a subject of scrutiny at the hearing, and they should have introduced evidence that would have supported their assertions about the transactions, including whatever background information was necessary to understand the transactions.

Second, we question whether the additional evidence Applicants sought to adduce was material. Applicants have failed to show that FCS was in the business of buying and selling evidences of indebtedness. Moreover, the Notes, the "Buy-Sell" Agreements, and the UCC Financing Statements all state on their face that Ventures, a corporate entity, is a party to the transactions in question.

For these reasons, we deny the Additional Evidence Motion.[35]

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[35] We also deny Applicant's request for a hearing on the Additional Evidence Motion.

In the Additional Evidence Motion, Applicants refer to a motion they filed on October 31, 2008 (the "2008 Motion"), which sought "[a]ny and all documents FINRA has, or is aware of, pertaining to the multiple year review by FINRA" of the membership of the requester of the no-action letters discussed above. *See supra* notes 26-28 and accompanying text. Applicants filed the 2008 Motion pursuant to FINRA Rule 9251, which, in relevant part, requires Enforcement to "make available for inspection and copying by any Respondents, Documents prepared or obtained by interested FINRA staff in connection with the investigation that led to the institution of proceedings," and which further precludes Enforcement from withholding any documents or parts thereof that contain material exculpatory evidence.

Enforcement staff responded that Enforcement was "not in possession of these documents nor were they prepared or obtained during the course of the investigation that led to the institution of this proceeding. Moreover, Enforcement is not aware of any exculpatory documents applicable to the present matter." The hearing officer denied the 2008 Motion based on Enforcement's response and Applicants' failure to demonstrate that the requested documents were relevant to the issue in the proceeding.

(continued...)

* * *

For the reasons set forth above, we sustain FINRA's findings that Applicants failed to file audited annual reports for fiscal years 2006 and 2007, and failed to show that the Exemption permitted them to file unaudited annual reports for those years.

V.

Exchange Act Section 19(e)(2) directs us to sustain FINRA's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition. [36] FINRA fined Applicants $5,000, jointly and severally, and suspended FCS for four months, ordering that the suspension would convert to an expulsion if FCS did not file audited annual reports for 2006 and 2007 before the suspension ended.

We initially observe that the sanctions imposed by FINRA were consistent with its Sanction Guidelines.[37] The Guidelines contain no specific guideline applicable to the failure to file audited annual reports. The Guidelines for the late filing of FOCUS reports, however, recommend a fine between $10,000 and $50,000 for a failure to file as well as a suspension of the firm for up to thirty business days and a suspension of the responsible principal for up to two years.[38] Those Guidelines also recommend taking into consideration whether the respondents delayed filing the report to prevent disclosure of a recordkeeping, operational, or financial deficiency. The Guidelines also generally recommend considering whether the respondents engaged in the misconduct notwithstanding prior warnings from FINRA or another regulator that the conduct violated FINRA rules or applicable securities laws or regulations.

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[35] (...continued)

It is unclear whether Applicants seek review of the denial of the 2008 Motion or whether they seek some other type of relief. However, Applicants point to no evidence contradicting the staff's representation that Enforcement had no documents responsive to the request and knew of no applicable exculpatory documents. To the extent Applicants object to this ruling, we see no basis for reversing it.

[36] 15 U.S.C. § 78s(e)(2). Applicants do not allege, and the record does not show, that FINRA's action imposed an undue burden on competition.

[37] *See* FINRA Sanction Guidelines (2007). Although the Commission is not bound by the Sanction Guidelines, it uses them as a benchmark in conducting its review under Exchange Act Section 19(e)(2). *E.g., Mission Sec. Corp.*, Exchange Act Rel. No. 63453 (Dec. 7, 2010), 99 SEC Docket 35510 A1, 35510 A21 n.44.

[38] The Guidelines recommend that, when a violation is not specifically addressed, Guidelines for analogous violations should be considered in formulating sanctions.

We find the sanctions imposed by FINRA appropriately remedial. The prompt filing of audited annual reports is an important requirement that provides FINRA and the Commission with "an important means of timely oversight of the financial health of broker-dealers and of protecting public investors."[39] Applicants refused to file audited annual reports despite repeated warnings that their operations did not satisfy the Exemption, and, more than three and four years later, they have still not filed the audited reports at issue. The fine imposed is lower than the bottom of the recommended range, in keeping with the small size and lack of business of FCS.[40]

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[39] *See Clinger & Co.*, 51 S.E.C. 924, 926 (1993) (requiring that reports be not just timely mailed, but timely received).

[40] The General Principles Applicable to All Sanctions Determinations state that adjudicators "should consider firm size with a view toward ensuring that the sanctions imposed are not punitive but are sufficiently remedial to achieve deterrence."

The suspension allows FCS ample time to file audited annual reports, given the extremely limited nature of its business in 2006 and 2007. The conversion of the suspension into expulsion is also an appropriate remedial measure if Applicants' failure to comply continues. We also conclude that the sanctions imposed on Applicants will have the salutary effect of deterring others from engaging in the same serious misconduct. [41]

An appropriate order will issue. [42]

By the Commission (Commissioners CASEY, WALTER, and PAREDES; Chairman SCHAPIRO and Commissioner AGUILAR not participating).

Elizabeth M. Murphy
Secretary

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[41] In making this determination, we note that although "'general deterrence is not, by itself, sufficient justification for expulsion or suspension . . . it may be considered as part of the overall remedial inquiry.'" *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1066 (D.C. Cir. 2007) (quoting *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005)); *see also Boruski v. SEC*, 289 F.2d 738, 740 (2d Cir. 1961) ("The public interest requires that appropriate sanctions be imposed to secure compliance with the rules, regulations, and policies of both NASD and SEC.").

[42] We have considered all of the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein. Because the issues have been thoroughly briefed and can be adequately determined on the basis of the record filed by the parties, Applicants' request for oral argument is denied. Rule of Practice 451, 17 C.F.R. § 201.451.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 64852 / July 11, 2011

Admin. Proc. File No. 3-14015

In the Matter of the Application of

FCS SECURITIES
and
DALE EDWARD KLEINSER
417 E. 90th Street Suite 8C
New York, NY 10128-5175

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that FINRA's findings that FCS Securities and Dale Edward Kleinser violated Section 17(e) of the Securities Exchange Act of 1934, Exchange Act Rule 17a-5, and NASD Rule 2110 be, and they hereby are, sustained; and it is further

ORDERED that the sanctions imposed by FINRA be, and they hereby are, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary