

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2009-0191259**

**To: Department of Enforcement
Financial Industry Regulatory Authority (FINRA)**

**Re: Capital Financial Services, Inc.
CRD No. 8408**

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Capital Financial Services, Inc. (CFS) submits this Letter of Acceptance, Waiver and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against CFS alleging violations based on the same factual findings described herein.

I. ACCEPTANCE AND CONSENT

- A. CFS hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

Background

CFS has been a FINRA broker-dealer since January 1981. CFS conducts a general securities business from its main office in Minot, North Dakota.

Relevant Disciplinary History

CFS has not been the subject of any FINRA disciplinary actions that are relevant to this matter.

Overview

CFS failed to have reasonable grounds to believe that private placements offered by Medical Capital Holdings, Inc. (MedCap) and Provident Royalties, LLC (Provident) pursuant to Regulation D were suitable for any customer. CFS failed to conduct adequate due diligence of the MedCap and Provident private placements and failed to establish, maintain and enforce a supervisory system reasonably designed to achieve compliance with applicable securities laws and regulations in connection with the sale of the MedCap and Provident private placements. Through these actions,

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CFS violated NASD Conduct Rules 2310, 3010 and 2110 and FINRA Rule 2010.

Facts and Violative Conduct

A. MedCap Private Placement Offerings.

MedCap was a medical receivables financing company based in Anaheim, California. MedCap's core business was to provide financing to healthcare providers by purchasing their accounts receivable and making secured loans to the providers.

In 2001, MedCap began raising funds for its operations by selling promissory notes through FINRA-registered firms. These notes were securities that were not registered with the SEC but were sold under the registration exemption provided by Rule 506 of Regulation D of the Securities Act of 1933. Pursuant to that exemption, the notes could be sold only to accredited investors.

From 2001 through 2009, MedCap raised approximately \$2.2 billion from over 20,000 investors through nine Regulation D offerings offered through FINRA broker-dealers and other sales avenues. Each investor purchased a minimum of \$25,000 in promissory notes with maturities ranging from one to seven years. The notes promised payments at annual interest rates ranging from 8.25% to 10.50%. During this entire period of time, however, MedCap never obtained any audited financial statements with respect to any of these offerings.

MedCap made all interest and principal payments on these Regulation D offerings until July 2008. At that time, MedCap began experiencing liquidity problems and stopped making payments on two of its earlier offerings. Nevertheless, MedCap proceeded with its last Regulation D offering, called Medical Provider Financial Corporation VI (MPFC VI), which it offered through an August 5, 2008 private placement memorandum. In this offering, MedCap sought to sell up to \$400,000,000 of promissory notes with two, three and six-year terms, at annual interest rates ranging from 9% to 9.5%. MPFC VI differed from some of MedCap's earlier offerings in several respects, including: it allowed MedCap to use up to 40% of the proceeds raised to invest in businesses other than medical receivables, and it limited the trustees' power to oversee MedCap's operations.

In July 2009, the SEC filed a civil injunctive action in federal district court in which it sought and was granted a preliminary injunction to stop all

MedCap sales. The SEC alleged that MedCap and its executives defrauded investors in MPFC VI by misappropriating approximately \$18.5 million of investor funds. The SEC also alleged that MedCap had misrepresented that it had never defaulted on or been late in making interest or principal payments, when in fact MedCap had defaulted or was late in paying nearly \$1 billion in principal and interest on the notes from its Regulation D offerings. The court appointed a receiver to gather and conduct an inventory of MedCap's remaining assets. The SEC action is pending.

B. CFS' Supervisory Failures Regarding Its MedCap Sales

CFS began selling the MedCap private placements in July 2003. From July 2003 through July 2008, CFS representatives visited MedCap's offices in Anaheim several times to review records and meet with MedCap's executives. CFS also received numerous third-party due diligence reports for MedCap's offerings. However, CFS never obtained financial information about MedCap and its offerings from independent sources, such as audited financial statements.

On July 30, 2008, CFS received an email from MedCap containing a draft PPM for MPFC VI and a selling agreement for CFS to sign if it chose to sell MPFC VI. MedCap informed CFS that the PPM would be finalized shortly without substantial revisions. CFS signed the selling agreement the very next day – on July 31, 2008. Other than reviewing the draft PPM, CFS conducted no due diligence on MPFC VI before approving this new product for sale by its brokers, even though this offering differed from some of MedCap's earlier offerings. On August 5, 2008, MedCap finalized the PPM, and CFS brokers began offering MPFC VI to their customers.

On August 7, 2008, CFS received a letter from MedCap. In this letter, MedCap stated that it was experiencing liquidity issues. MedCap further stated that it had not repaid principal to some clients but it expected to correct this problem within 30 days. Upon receipt of this letter, CFS suspended sales of MPFC VI.

On August 20 and 21, 2008, four CFS representatives visited MedCap's offices in Anaheim to review MedCap's records. The CFS representatives met with key MedCap personnel, toured the MedCap facility and reviewed financial information provided by MedCap. MedCap's executives blamed the national credit crisis for the liquidity issues and assured the CFS representatives that there would be no problems with the current MPFC VI offering. Based on this trip and other discussions with MedCap

executives, CFS allowed its brokers to resume offering MPFC VI to their customers on August 28, 2008.

Despite MedCap's assurances, the problems with its Regulation D offerings continued. MedCap repeatedly stated to CFS representatives that the interest and principal payments would occur within a few weeks. MedCap made some interest payments but failed to pay substantial amounts of interest and principal owed to its investors. These unfulfilled promises continued until July 2009 when the SEC filed its civil action and MedCap's operations ceased.

In addition to MedCap's ongoing delays in making payments to its investors, CFS received other red flags relating to MedCap's problems throughout the fall of 2008. These red flags included the following:

- One of CFS's custodial firms refused to hold the MedCap notes, as it deemed them worthless based on MedCap's failure to make principal and interest payments and was unable to value these notes.
- CFS's clearing firm valued the MedCap notes at zero on its customers' account statements, again due to MedCap's failed payments and its inability to value these notes.
- CFS received two third-party due diligence reports that highlighted MedCap's failed payments and warned of further potential problems.
- CFS received communications from another third-party due diligence provider, who indicated that MedCap was not allowing access to all of its records, thereby making it impossible to conduct any credible due diligence.

Despite these red flags, CFS continued to allow its brokers to sell MPFC VI to their customers. In total, 36 CFS brokers sold \$11,759,798.01 of MPFC VI to 145 customers. These sales occurred from August 5, 2008 through March 11, 2009.

C. Provident Private Placement Offerings

From at least September 2006 through January 2009, Provident Asset Management, LLC (PAM), marketed and sold preferred stock and limited partnership interests in a series of 23 private placements offered by an affiliated issuer, Provident Royalties, LLC, which was a non-registered

entity. PAM's only business line was acting as the wholesaling broker-dealer for the Provident offerings, which were sold to customers through more than 50 retail broker-dealers nationwide and which raised approximately \$485 million from over 7,700 investors. Provident's business plan included the acquisition of a combination of producing and non-producing sub-surface mineral interests, working interests and production payments in real property located within the United States.

The Provident offerings each claimed an exemption from the registration of the offerings pursuant to Rule 506 of Regulation D. The Provident offerings, designated as Shale Royalties, Inc., numbered II through 20 (Shale offerings), offered two series of non-convertible redeemable cumulative preferred stock. Each share of stock was offered for \$5,000 through a private placement memorandum. The Shale offerings were virtually identical in their terms, had the same investment purpose, and were offered continuously for 30 consecutive months. The periods of many of the offerings overlapped and each offering was also limited to 500 investors and to varying dollar amounts. As an offering would approach a limit, Provident would create the next Shale offering. Audited financial statements were not prepared with respect to any of the Shale offerings.

At the outset of the Shale offerings by Provident, dividends on each share of Series A preferred stock were to accrue at the rate of 1.5% per month, and dividends on each share of Series B preferred stock were to accrue at the rate of 1.25% per month. Series A preferred stock was redeemable at the end of either 24 or 36 months, and Series B preferred stock at the end of 24 months. At some point in time, Provident reduced the amount payable for dividends on Series A preferred stock to 1.375% and on Series B preferred stock to 1.167%. At the same time, the private placement memoranda for the Shale offerings changed the maturity to 48 months for Class A Preferred Shares and 36 months for Class B Preferred Shares. Dividend payments to the investors were to be paid four months in arrears, and thereafter monthly on the last day of each month.

Although PAM made some direct retail sales of the Provident private placements, it primarily solicited retail broker-dealers to enter into sales agreements for each Shale offering, and those retail broker-dealers sold the stock of the offerings to investors nationwide. The retail broker-dealers received fees and/or commissions for soliciting investors in the Shale offerings, including a specific fee related to due diligence that was purportedly performed in connection with each offering. In an effort to market the Shale offerings, PAM made presentations to retail broker-dealers in its Dallas, Texas offices, during which it represented that: (1)

investors' funds would be used by each individual Provident offering to purchase interests in the oil and gas business for that offering; (2) the subscription proceeds of each offering would be deposited into an account for that offering and become assets for that offering; (3) approximately 86% of the subscription proceeds would be allocated to acquiring interests in the oil and gas business; and (4) dividends paid to investors would be derived from revenues, primarily from the sale of oil and gas assets.

The owners and principals of Provident deposited investors' funds into the appropriate separate bank account designated for each Shale offering, knowing that the Shale offerings did not have sufficient revenues to pay investors' dividends as they became due. Although a portion of the proceeds of the Shale offerings was used for the acquisition and development of oil and gas exploration and development activities, millions of dollars of investors' funds were transferred from the later Shale offerings' bank accounts to the Provident operating account in the form of undisclosed and undocumented loans, and were used to pay dividends and returns of capital to investors in the earlier Shale offerings.

The owners and principals of Provident and PAM did not tell investors, and the Shale private placement memoranda do not disclose, that the investors' funds would be used to pay earlier investors their dividends and return of principal, rather than being invested in oil and gas assets.

On July 2, 2009, the SEC filed a civil injunctive action in the Northern District of Texas naming Provident, PAM and others, and the Court granted its request for a temporary restraining order and an emergency asset freeze and appointment of a receiver to take control of the entities and marshal and preserve the assets for the benefit of the defrauded investors. The Court set a hearing on the SEC's motion for a preliminary injunction. Subsequently, the order for the hearing was vacated when all the named defendants agreed to the entry of a preliminary injunction, which remains in effect.

D. CFS' Supervisory Failures Regarding Its Provident Sales

CFS began selling the Provident offerings in September 2006. CFS representatives visited Provident's offices in Dallas in January 2007 to review records and meet with Provident's executives. CFS also received numerous third-party due diligence reports for Provident's offerings. However, CFS never obtained financial information about Provident and its offerings from independent sources, such as audited financial statements.

CFS executed sales agreements with Provident for the various Shale offerings. CFS received fees and/or commissions for soliciting investors in these Shale offerings, including a specific fee related to due diligence that was purportedly performed in connection with each offering.

On July 28, 2008, CFS signed a sales agreement that allowed its brokers to market and sell the Shale 14 offering. From July 28, 2008 through November 4, 2008, brokers at CFS sold \$8,060,000 of Shale 14 to 130 customers.

On August 28, 2008, CFS signed a sales agreement that allowed its brokers to market and sell the Shale 17 offering. From September 2, 2008 through November 19, 2008, brokers at CFS sold \$3,010,000 of Shale 17 to 48 customers.

On October 20, 2008, CFS signed a sales agreement that allowed its brokers to market and sell the Shale 18 offering. From October 23, 2008 through January 22, 2009, brokers at CFS sold \$7,495,000 of Shale 18 to 102 customers.

Despite the fact that CFS received a specific fee related to due diligence that was purportedly performed in connection with each offering, CFS performed little due diligence beyond reviewing the private placement memoranda for the Shale 14, Shale 17 and Shale 18 offerings. CFS representatives did not travel to Provident's headquarters in Dallas to conduct any due diligence for these Shale offerings in person. In addition, CFS did not see or request any financial information for Provident other than that contained in the private placement memoranda.

CFS first obtained a third-party due diligence report for one of these Shale offerings on December 30, 2008, after having sold these Shale offerings for five months already. This report identified a number of red flags with respect to the Shale 18 offering. For instance, the report detailed that the affiliated Shale offerings were collectively reporting a net operating loss for the first nine months of 2008, and in the absence of additional credit line funds, Provident's operating funds would need to come from (i) a higher level of production revenues going forward, or (ii) future divestitures of lease/mineral assets in order to pay dividends and principle redemptions when they became due. In addition, the reports noted that certain Shale offerings were advancing funds to, or buying assets from, other Shale offerings. The reports observed that, because of the lack of transparency in Provident's financial statements, it was difficult to ascertain the asset and liability positions of the Shale offerings at any given moment in time. Finally, the reports cautioned that the financial statements for the affiliated

Shale offerings had not been formally audited or confirmed by an outside accounting firm necessary to validate the financial information reported by Provident.

CFS should also have been particularly careful to scrutinize each of the Shale offerings given the purported high rates of return. However, it did not take the necessary steps, through obtaining financial information or otherwise, to ensure that these rates of return were legitimate, and not payable from the proceeds of later offerings, in the manner of a Ponzi scheme. CFS also did not follow up on the red flags that were documented in the third-party due diligence report. Even with notice of these red flags, CFS continued to sell the Shale offerings without conducting any meaningful due diligence.

Violations

A. Rule 2310

NASD Conduct Rule 2310 requires that a FINRA firm, when making a recommendation to a customer to purchase or sell a security, have reasonable grounds to believe that the recommendation is suitable for such customer. To comply with Rule 2310, a FINRA firm must have an understanding of the potential risks and rewards of the security. A firm must conduct due diligence on its securities products in order to understand the inherent risks of these products and to determine whether these products are suitable for its customers. This due diligence is especially important for alternative investments such as Regulation D offerings, where there is no registration of the securities with the SEC. Rule 2310 may be violated if a firm or the selling broker has no reasonable grounds to believe that the security is suitable for any customer.

CFS failed to have reasonable grounds for approving the sale and allowing the continued sale of the Medical Capital and Provident offerings. Even though CFS was aware of numerous red flags and negative information that should have alerted it to potential risks, the firm allowed its brokers to continue selling these private placements.

Through these actions, CFS violated NASD Conduct Rule 2310; NASD Conduct Rule 2110 (from July 22, 2008 through December 14, 2008); and FINRA Rule 2010 (from December 15, 2008 through March 11, 2009).

B. Rule 3010

NASD Conduct Rule 3010(a) requires member firms to establish, maintain

and enforce a supervisory system reasonably designed to achieve compliance with applicable securities laws and regulations and NASD Rules and FINRA Rules. Required components of a "reasonable" supervisory system include, among other things, enforcing written supervisory procedures designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. Broader than its counterpart under the Securities Exchange Act of 1934, Section 15(b)(4)(E), NASD Conduct Rule 3010 imposes an "affirmative obligation" on NASD broker-dealers to establish, and enforce, supervisory systems.

CFS did not conduct meaningful due diligence for the Medical Capital and Provident offerings prior to approving them for sale to CFS' customers. Without adequate due diligence, CFS could not identify and understand the inherent risks of these offerings. The firm failed to enforce reasonable supervisory procedures to detect or address potential red flags and negative information as it related to these private placements. CFS therefore failed to maintain a supervisory system that was reasonably designed to achieve compliance with applicable securities laws and regulations.

Through these actions, CFS violated NASD Conduct Rule 3010; NASD Conduct Rule 2110 (from July 22, 2008 through December 14, 2008); and FINRA Rule 2010 (from December 15, 2008 through March 11, 2009).

B. CFS also consents to the imposition of the following sanctions:

CFS is censured.

On or before September 1, 2011, CFS shall pay restitution to the investors in the securities offerings of Medical Capital Holdings, Inc. in the total amount of \$80,000. For the purpose of distributing such restitution, it shall be paid to Thomas Seaman, Receiver, appointed by the United States District Court for the Central District of California in *Securities and Exchange Commission v. Medical Capital Holdings, Inc., et al.* [Civil Action No. SA CV09-0818 DOC(RNBx) (C.D. Cal.)]. Receiver Seaman has agreed to distribute such restitution to the investors in the Medical Provider Financial Corporation VI securities offering of Medical Capital Holdings, Inc. on a pro rata basis in accordance with the distribution mechanism established by the United States District Court for the Central District of California in the above-referenced civil action, but in no event shall the restitution paid pursuant to this AWC be reduced by attorneys' fees or any other fees or costs. If a distribution mechanism is not established by the United States District Court in the above-referenced

civil action by December 1, 2011, then the Receiver has agreed to propose a distribution plan for FINRA's approval.

On or before September 1, 2011, CFS shall pay restitution to the investors in the securities offerings of Provident Royalties, LLC in the total amount of \$120,000. For the purpose of distributing such restitution, it shall be paid to Dennis L. Roossien, Jr., Receiver, appointed by the United States District Court for the Northern District of Texas in *Securities and Exchange Commission v. Provident Royalties, LLC, et al.* [Civil Action No. 3:09-CV-01238-L-BH; Northern District of Texas (Dallas)]. Receiver Roossien has agreed to distribute such restitution to the investors in the Shale Royalties 14, Shale Royalties 17 and Shale Royalties 18 securities offerings of Provident Royalties, LLC on a pro rata basis in accordance with the distribution mechanism established by the United States District Court for the Northern District of Texas in the above-referenced civil action, but in no event shall the restitution paid pursuant to this AWC be reduced by attorneys' fees or any other fees or costs. If a distribution mechanism is not established by the United States District Court in the above-referenced Civil Action by December 1, 2011, then the Receiver has agreed to propose a distribution plan for FINRA's approval.

A registered principal on behalf of CFS shall submit satisfactory proof of payment of this restitution or of reasonable and documented efforts undertaken to effect this restitution. Such proof shall be submitted to James M. Stephens, FINRA Senior Regional Counsel, 120 West 12th Street, Suite 800, Kansas City, MO 64105 by letter that identifies CFS and Case No. 20090191259 no later than 120 days after acceptance of the AWC.

CFS has specifically and voluntarily waived any right to claim an inability to pay at any time hereafter the monetary sanction(s) imposed in this matter.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II. WAIVER OF PROCEDURAL RIGHTS

CFS specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against CFS;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council (NAC) and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, CFS specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

CFS further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III. OTHER MATTERS

CFS understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against CFS; and
- C. If accepted:
 - 1. this AWC will become part of CFS's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against

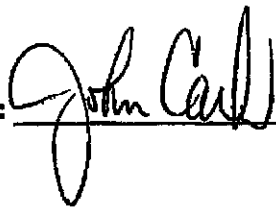
CFS;

2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about CFS's disciplinary record;
 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 4. CFS may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. CFS may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects CFS's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. CFS may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. CFS understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

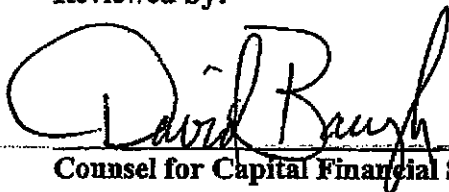
The undersigned, on behalf of CFS, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that I have agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce CFS to submit it.

CAPITAL FINANCIAL SERVICES, INC.

Date: 6-28-2011

By: 

Reviewed by:



Counsel for Capital Financial Services, Inc.

Letter of Acceptance, Waiver and Consent No. 20090191259
Capital Financial Services, Inc.
Page 13

Accepted by FINRA:

8/3/11
Date

**Signed on behalf of the Director of ODA,
by delegated authority**

By:


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