BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC

In the Matter of the Application of

Mitchell H. Fillet

For Review of Disciplinary Action

Taken by

FINRA

File No. 3-15601

BRIEF OF FINRA IN OPPOSITION TO APPLICATION FOR REVIEW

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BRIEF OF FINRA IN OPPOSITION TO APPLICATION FOR REVIEW

I. INTRODUCTION

This case involves the breach of Applicant Mitchell H. Fillet's ("Fillet") obligations as a registered representative to provide accurate and complete information to an investor in a private offering of securities and of Fillet's responsibility to ensure the accuracy of firm records—records that Fillet intentionally falsified and provided to FINRA as authentic. In the first instance, Fillet drafted private placement documents for an offering of securities in which he made numerous misrepresentations about the issuers. Fillet represented that these issuers were national-scope companies that had a key operating license. None of this was true at the time and Fillet knew it. One issuer was a shell, with no assets or operations, and the other was merely a concept that could not proceed without a critical licensing agreement from the well-known toy store, FAO Schwarz ("FAO"), and the FAO Family Trust. Fillet also failed to disclose that the

issuers' CEO, who was critical to the success of the securities offering, had an extensive criminal history.

Misrepresenting what he knew to be the issuers' true operating status while ignoring the relevant criminal history of the issuers' CEO, Fillet pitched the private placement to an investor who subsequently invested $150,000 in the offering. When the CEO's criminal history was revealed and the licensing agreement was never effectuated, the offered securities became worthless and the investor lost his entire investment. Fillet, however, disclaims all responsibility, blames others, including the investor that he duped, and incredulously portrays himself as the hapless victim.

Fillet's pattern of deceit in this case also extends to his duties as a registered principal to provide supervisory approval of customers' variable annuity transactions. Rather than fulfilling his obligation to provide timely supervisory review, Fillet backdated his approval of the transactions and then provided the falsified documents to FINRA staff during an on-site examination of his firm. Fillet's deception created inaccurate books and records of his firm.

As the National Adjudicatory Council ("NAC") held, the record amply supports the findings that Fillet acted fraudulently, unethically, and in violation of FINRA rules. Fillet made misrepresentations and omissions to an investor in a securities offering; he falsified documents related to seven customers' variable annuity transactions; and he attempted to deceive FINRA by providing these documents to FINRA staff during an on-site examination.

Consistent with the FINRA Sanction Guidelines ("Guidelines") and the seriousness of Fillet's misconduct, the NAC suspended Fillet for three and a half years from association with any member firm in any capacity and fined him $20,000 for this misconduct. FINRA's sanctions are fully warranted. Fillet placed his interests in marketing a private securities offering above the

interests of an investor who needed complete and accurate information when deciding to participate in the offering. Fillet's backdating of firm documents and provision of these false documents to FINRA further exemplifies the egregiousness of his ethical breach and his willingness to misrepresent the truth to suit his needs.

In an effort to evade responsibility for his misconduct, Fillet now soft pedals his actions and blames others, relying on his own unsupportable, self-serving statements as a basis for much of his arguments. But the factual bases of the NAC's findings are fully supported. Fillet's misconduct squarely reflects on his ability to comply with regulatory requirements necessary to the proper functioning of the securities industry and protection of the investing public. Because the record fully establishes the NAC's findings and supports the sanctions imposed, the Commission should dismiss Fillet's application for review.

II. FACTUAL BACKGROUND

A. Fillet's Background

Fillet first registered as a general securities representative in 1981. (RP 855.)[1] Fillet's misconduct at issue here occurred while he was registered as a general securities representative and principal with The Riderwood Group ("Riderwood" or the "Firm"). (RP 852.) Fillet was Riderwood's CEO, President, and senior investment banker, and he held an ownership interest in the Firm. (RP 572, 709; BrokerCheck Report at 4, attached as Exhibit 1.) Riderwood conducted both a traditional brokerage business and an investment banking business, including private

[1] "RP" refers to the page numbers in the certified record of this case filed with the Commission.

placements, mergers, and acquisitions. (RP 572.) Fillet is not currently associated with a FINRA member. (RP 709, 782, 851.)

B. The Engagement Agreement and Fillet's Relationship with Allan Sloan

Centrally at issue here are the misleading statements that Fillet made in offering documents that he drafted pursuant to an engagement agreement for a private placement of securities to be issued by Catering Acquisition Corp. ("CAC") and FAO Sweet Shoppes, Inc. ("FAO Sweet Shoppes") and during the solicitation of Peter Malkin's ("Malkin") investment in the offering. CAC was a shell company created for the purpose of acquiring food service companies and had no assets or business operations. (RP 717.) FAO Sweet Shoppes, like CAC, had no operations, but its intended business model was a retail store that combined toys, food, and party facilities. (RP 728, 907.)

Fillet's involvement in this securities offering began when he, on behalf of Riderwood, entered into an engagement agreement with CAC, and its principal Allan Sloan ("Sloan"), in June 2007. (RP 716, 857-61.) Sloan would be in charge of both CAC and FAO Sweet Shoppes. (RP 908.) Fillet and Riderwood agreed to provide CAC with "advisory, investment banking, and placement services" in connection with "the acquisition of a series of food-related enterprises" in New York City and "the creation of a food and food service brand." (RP 857.) Fillet and Riderwood further agreed to conduct due diligence, help structure a financing plan, draft transactional documents, identify prospective investors, and act as a placement agent in connection with CAC's private offering of its securities. (RP 717, 858.) Sloan paid Riderwood between $20,000 and $30,000 for its services. (RP 736.)

In late 2007, Fillet learned that Sloan was a convicted felon. (RP 711, 718, 752-55, 1164.) When Malkin invested in the CAC and FAO Sweet Shoppes offering, Fillet knew that Sloan had been convicted of possession of a stolen rental car in 2002, for which he was sentenced to three to six years in prison, but Fillet did not disclose these facts to Malkin. (RP 611, 722, 711, 718, 743, 752-55, 781, 1164.) Instead, Fillet told Sloan to disclose it to Malkin and FAO, which Sloan never did. (RP 609, 611, 722, 743, 781.) Fillet also did not include any of Sloan's criminal history in the CAC and FAO Sweet Shoppes offering documents. (RP 654, 656.)

C. Fillet Drafted Misleading Private Placement Offering Documents

Pursuant to the engagement agreement, Fillet drafted a "Confidential Term Sheet" ("Term Sheet"), promissory notes, and a subscription agreement for the offering. (RP 719-20.) The January 14, 2008 Term Sheet at issue here prominently identified Riderwood as the "sole" and "exclusive" "marketing agent" for the offering and listed Fillet as the primary contact person for information about the offering. (RP 906, 909.)

Fillet made numerous misrepresentations in the Term Sheet about CAC and FAO Sweet Shoppes. Fillet represented that CAC "was founded in 2007 to create a vertically-integrated, brand name food service company that started in New York City but became national in scope." (RP 907.) Fillet falsely represented that CAC was a nationally "going business" when, in fact, Fillet was aware of its status as a shell with no assets or operation. (RP 717, 729, 770, 907.) Fillet represented that there was an agreement in place with FAO and that FAO Sweet Shoppes was acting pursuant to a global license with FAO and the FAO Family Trust. (RP 726-29, 907.) As Fillet knew, however, FAO Sweet Shoppes was merely in the concept stage at that time. (RP

726.) Fillet also was well-aware that Sloan had no agreement in place with FAO and he had not secured the necessary licenses from FAO and the FAO Family Trust. (RP 726-27, 729.)

By Fillet's own admission, the Term Sheet's description of CAC's and FAO Sweet Shoppes' businesses was subject to contingencies that had not occurred as of the date of the Term Sheet, January 14, 2008. (RP 726-27.) Despite these misleading statements, Fillet did nothing to prevent the Term Sheet from being used in its inaccurate form to solicit Malkin's investment in the CAC/FAO Sweet Shoppes offering. (RP 723-24, 756-59, 781.)

D. Malkin's Investment

In December 2007, Edward Schmults ("Schmults"), the then CEO of FAO, told his friend Malkin about the FAO Sweet Shoppes venture. (RP 589-90.) Schmults asked Malkin to speak with Sloan regarding the first FAO Sweet Shoppes location. (RP 588, 591.) Schmults told Malkin that Sloan was an experienced food services operator and that FAO was relying on Sloan to run the business and on his judgment. (RP 628-29.)

Fillet met with Malkin on January 16, 2008, for the express purpose of determining whether Malkin would be interested in investing in the CAC/FAO Sweet Shoppes offering. (RP 591-593, 652, 721.) Malkin was under the impression that Fillet "was an investment banker who had done a lot of offerings," "participat[ed] to add credibility" to Sloan, and was "involved in raising the money." (RP 654, 606.) During the meeting, Malkin and Fillet discussed Sloan's business plan, the businesses of CAC and FAO Sweet Shoppes, the terms of the offering, Malkin's qualifications as an accredited investor, and Malkin's investment amount of $150,000. (RP 594-96, 652-53.) Through his conversations with Fillet and Sloan, Malkin understood that CAC was already operating a food preparation business that would provide the food for the FAO

Sweet Shoppes and that there was a license agreement in place with FAO. (RP 595-97, 653, 661, 905.) Malkin also understood that CAC was on the verge of acquiring a prominent New York catering company. (RP 592, 596, 653.)

Soon after the January 2008 meeting, Malkin received the Term Sheet, subscription agreement, and accompanying promissory notes.[2] (RP 597, 599, 600-02, 604, 863-90, 906-17.) Malkin completed and signed the subscription agreement that he dated February 21, 2008. (RP 597-98, 601-02, 910-17.) Malkin also issued a check payable to "Catering Acquisition Corp." for $150,000. (RP 598, 918.) Sloan picked up the completed documents and check from Malkin. (RP 598, 604.)

Malkin became "uncomfortable" with his investment after several conversations with Sloan in the following months. (RP 606.) Sometime thereafter, Schmults told Malkin that FAO's "arrangement" with Sloan had been terminated. (RP 609.) Schmults instructed Malkin to "Google" Sloan, and Malkin then discovered Sloan's criminal history. (RP 609.)

Malkin subsequently requested reimbursement of his investment from Fillet and Sloan. (RP 607, 610-11.) Fillet disclaimed any responsibility to return the money. (RP 607; Br. at unnumbered pages 2, 4.) Sloan agreed to repay Malkin, and, on three different occasions, Sloan gave Malkin a check for $150,000. (RP 611-12.) Each of the checks bounced, however, and Malkin never recovered any of his investment. (RP 611-13.)

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[2] Fillet testified that he provided the documents to Sloan's attorney and later became aware that Malkin was provided the Term Sheet. (RP 720, 724.)

E. Fillet Falsified Documents and Provided Them to FINRA

During a July 2008 on-site examination of Riderwood's main office in Maryland, FINRA examiner Stephen Marchese ("Marchese") reviewed the suitability of the Firm's variable annuity transactions. (RP 573.) Marchese interviewed Fillet, who was the supervisor overseeing these transactions. (RP 571, 667-68, 710.) Fillet told Marchese that most of the variable annuity business was done in Riderwood's branch offices. (RP 667.) Fillet stated that after the registered representative in the branch completed the relevant forms, the forms were faxed to him to review for suitability. (RP 667-68.) The forms included date and signature lines for the reviewing supervisor. (RP 1003-08, 1011-16, 1017-22, 1023-28, 1029-32, 1033-39, 1041-44, 1045-58, 1059-70, 1075-87, 1091-1103.) Fillet explained that after he conducted a suitability review, he faxed the forms back to the branches, where the documents were maintained. (RP 668.)

Marchese requested a sampling of the Firm's variable annuity account documents for his review. (RP 666-67.) Marchese testified that the Firm produced the documents extremely slowly. (RP 669.) When the documents were provided, Marchese discovered that Fillet had not signed the requested documents being faxed by the branch offices. (RP 670-71.) Marchese explained that while waiting in a Firm conference room for Fillet to produce documents, unbeknownst to Fillet, Marchese saw several faxes of variable annuity documents that were sent from the Firm's Michigan and Indiana branch offices. (RP 671-72.) These documents contained none of the required supervisory signatures. (RP 672.) In addition, a fax cover sheet from a registered representative at the Indiana branch requested Fillet's signature on the documents. (RP 671-72.) Fillet subsequently produced these same documents to Marchese, but not until he

had signed and dated them as though Fillet's supervisory review occurred around the time of the transactions. (RP 672.)

Fillet, however, repeatedly denied to FINRA that he engaged in backdating. (RP 997, 1111-1113, 1116-17, 1122-26.) In Fillet's response to FINRA staff's examination report in which FINRA found that Riderwood engaged in the "backdating of the Principal approval for the variable annuity transactions" for seven Firm customers, Fillet insisted there was "no backdating of those documents." (RP 997, 1000.) Fillet also denied backdating countless times in on-the-record investigative testimony provided to FINRA. (RP 1111-1113, 1116-17, 1122-26; *see infra* note 27.)

III. PROCEDURAL BACKGROUND

FINRA initiated disciplinary proceedings in this matter in August 2010 when the Department of Enforcement ("Enforcement") filed its complaint. (RP 1-14.) Enforcement alleged that Fillet made misrepresentations and omissions to Malkin in connection with the sale of securities, in violation of Securities Exchange Act of 1934 ("Exchange Act") § 10(b), Exchange Act Rule 10b-5, NASD Rules 2120 and 2110, and IM-2310-2. (RP 6, 8-10.) Enforcement further alleged that Fillet falsified Firm documents related to seven customers' variable annuity transactions, which resulted in Riderwood's books and records being inaccurate, and provided these documents to FINRA, in violation of NASD Rules 3110 and 2110. (RP 6-7, 10-11.)

The Hearing Panel found that Fillet engaged in the alleged misconduct. (RP 1204, 1212-16.) The Hearing Panel suspended Fillet for two years and fined him $10,000 for falsifying the documents that caused the Firm's inaccurate books and records. (RP 1217.) The Hearing Panel

imposed a concurrent six-month suspension and additional $10,000 fine for the fraud. (RP 1216-17.) Fillet's appeal to the NAC followed.[3] (RP 1219.)

The NAC affirmed the Hearing Panel's findings that Fillet, in soliciting Malkin's investment in the private placement of CAC's and FAO Sweet Shoppes' securities, misrepresented and omitted material information that Fillet was required to disclose and acted with scienter. (RP 1449-57.) The NAC also affirmed the Hearing Panel's findings that Fillet caused the inaccuracy of his Firm's books and records by backdating variable annuity account documents and provided these false documents to FINRA.[4] (RP 1458-59.)

The NAC sanctioned Fillet by suspending him for 18 months in all capacities and fining him $10,000 for the fraud. (RP 1461-63.) In determining to increase the sanctions for fraud, the NAC found aggravating factors that supported stiffer sanctions. (RP 1461-63.) The NAC also suspended Fillet for an additional two years and fined him $10,000 for causing his Firm's books and records to be inaccurate and providing these false records to FINRA. (RP 1463-65.)

On November 1, 2013, Fillet filed this appeal with the Commission. (RP 1495-99.)

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[3] Fillet points to "two previous FINRA sponsored hearings" that he argues "ignored many important facts" and undercuts a finding of liability for fraud. (Br. at 2, 4.) The NAC's decision is the final action of FINRA; thus, the Commission reviews the NAC's decision—not the Hearing Panel's. *See* 15 U.S.C. § 78s(e); FINRA Rules 9351(e), 9370(a). Any findings of the Hearing Panel that are contrary to the NAC's findings are irrelevant. *See Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 SEC LEXIS 3176, at *21 n.17 (Nov. 8, 2006).

[4] Enforcement alleged in its complaint that Fillet backdated documents related to ten variable annuity transactions, an allegation that the NAC affirmed. (RP 11, 1458-59.) On appeal to the Commission, Fillet acknowledges that he "miss-dated" 11 variable annuity contracts. (Br. at 5.)

IV. ARGUMENT

A. The Record Supports the NAC's Finding that Fillet Engaged in Fraud

The evidence demonstrates that Fillet defrauded Malkin by preparing and using materially misleading offering documents to sell securities in a private placement, and supports the NAC's findings that Fillet violated Exchange Act § 10(b), Exchange Act Rule 10b-5, NASD Rules 2110 and 2120, and IM-2310-2. Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 prohibit the use, in connection with the purchase or sale of any security, of any fraudulent and deceptive acts and practices.[5] For the Commission to sustain the NAC's findings that Fillet violated § 10(b) and Rule 10b-5, the evidence must show that Fillet (1) made material misrepresentations or omissions; (2) in connection with the purchase or sale of a security; and (3) acted with scienter.[6] *See Basic Inc. v. Levinson*, 485 U.S. 224, 235 n.13 (1988); *SEC v. First*

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[5] Conduct that violates Commission or FINRA rules is inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of NASD Rule 2110. *Joseph Abbondante*, 58 S.E.C. 1082, 1103 (2006), *aff'd*, 209 F. App'x 6 (2d Cir. 2006). NASD Rule 0115 makes all NASD rules applicable to both FINRA members and all persons associated with FINRA members.

[6] Fillet does not dispute that he communicated through telephone calls or the U.S. mail service, thereby satisfying the interstate commerce requirement. *See* 17 C.F.R. § 240.10b-5.

Fillet argues that FINRA was required to show that Malkin relied upon these misstatements and, as a result, suffered losses in order to prove that Fillet acted fraudulently. (Br. at 1, 4.) Fillet misunderstands the elements of fraud that FINRA must prove. Unlike a private litigant, the Commission has made clear that FINRA "is not required to prove reliance" nor damages suffered from such reliance. *Kevin M. Glodek*, Exchange Act Release No. 60937, 2009 SEC LEXIS 3936, at *14 (Nov. 4, 2009), *aff'd*, 416 F. App'x 95 (2d Cir. 2011); *Robert Tretiak*, 56 S.E.C. 209, 223 n.26 (2003). In any event, Malkin testified that he relied upon the representations in the Term Sheet and on Fillet's presentation to him in making his investment decision. (RP 601, 626-27, 656, 658.) Fillet also was a factor in Malkin's losses. *See infra* note 8.

Jersey Sec., Inc., 101 F.3d 1450, 1467 (2d Cir. 1996). A preponderance of the evidence establishes each of these elements.[7]

1. The CAC and FAO Sweet Shoppes Offering Involved the Sale of Securities

Fillet's misrepresentations and omissions in this case occurred in connection with the sale of securities.[8] Fillet mistakenly characterizes the private placement as a "loan," (Br. at 2-3) when the record clearly shows that this was a securities offering. The Term Sheet and subscription agreement described that each $150,000 investment unit included an $80,000 CAC "Series A 10% Corporate Note" due December 1, 2009, a $70,000 FAO Sweet Shoppes "Series A 10% Corporate Note" due December 1, 2009, and detachable warrants to purchase shares of

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[7] Throughout his brief, Fillet asserts that FINRA applied an incorrect standard of proof and that Enforcement was required to show "cogent and compelling" or "overwhelming" evidence of his fraud. (Br. at 2-4.) Fillet is mistaken and attempts to demand a more stringent burden than is required in proving FINRA disciplinary cases. The Commission and federal courts have held that the preponderance of the evidence standard of proof is applied in FINRA disciplinary proceedings, including cases involving the antifraud provisions. *See Gonchar v. SEC*, 409 F. App'x 396, 398-99 (2d Cir. 2010) (rejecting the petitioners' argument that the SEC erred in applying a preponderance of the evidence standard of proof in a FINRA fraud case); *William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *25 (July 2, 2013) (applying a preponderance of the evidence standard to determine whether the record supported FINRA's findings). Thus, under the preponderance of the evidence standard, the Commission should sustain FINRA's findings if the relevant facts are more likely than not. *See Howard Brett Berger*, Exchange Act Release No. 55706, 2007 SEC LEXIS 895, at *18 n.19 (May 4, 2007), *reh'g granted in part on other grounds*, Exchange Act Release No. 58950, 2008 SEC LEXIS 3141 (Nov. 14, 2008), *aff'd*, 347 F. App'x 692 (2d Cir. 2009).

[8] The Supreme Court has interpreted the concept of "in connection with" broadly. *See SEC v. Zandford*, 535 U.S. 813, 819 (2002). In *Zandford*, the Court held that a deceptive practice may be "in connection with" a securities transaction if it "coincide[s]" with the transaction. *Id.* at 820. Fillet's actions in marketing the securities offering to Malkin, which resulted in Malkin's investment, are considered "in connection with" an offer, sale, or purchase of securities.

CAC and FAO Sweet Shoppes. (RP 906, 908, 910.) Malkin purchased one $150,000 unit. (RP 910-919.) Malkin was told at the meeting with Fillet that that notes and warrants "would be coupled, . . . if you bought the notes you would get the warrants." (RP 594.) The Exchange Act's definition of a "security" includes a warrant to purchase stock. 15 U.S.C. §78c(a)(10). Other portions of the transactional documents that Fillet prepared plainly contemplate that the offering was a sale of securities, and not a personal loan as Fillet insists. The subscription agreement required an investor's acknowledgment that the units were "restricted securities under the 1933 Act inasmuch as they are being acquired from the Companies in the transaction not involving a public offering." (RP 911.) The NAC correctly found that CAC and FAO Sweet Shoppes offering involved the offer or sale of securities.[9]

2. Fillet Was the Maker of Misstatements Related to the Securities Offering

The record fully supports the NAC's findings that Fillet was the "maker" of misstatements that he used when marketing the offering to Malkin. In *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), the Supreme Court established what it means to "make a statement" for purposes of Rule 10b-5(b). The Court held that a mutual fund investment adviser, Janus Capital Management LLC ("JCM"), was not liable in a private implied right of action under Rule 10b-5(b) for false statements included in its client mutual funds' prospectus. *Id.* at 2301. The Court focused on who had "ultimate control" over the allegedly

[9] Fillet misguidedly asserts that the state of New York, rather than FINRA, has jurisdiction over this transaction. (Br. at 3.) FINRA has jurisdiction over Fillet who engaged in this misconduct while registered with Riderwood, a FINRA member. *See* Article V, § 4 of FINRA's By-Laws; (RP 851-52). Fillet is responsible as a registered person who participated in the perpetration of a fraud.

misleading statement. *Id.* at 2302. The "maker of a statement," according to the Court, "is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Id.* at 2302. In dismissing the allegations against JCM, the Court determined that nothing in the prospectus "indicate[d] that any statements therein came from" JCM rather than the investment fund. *Id.* at 2305.

In comparison, the record in this case establishes that the misstatements were attributable to Fillet and that Fillet had authority over the content of the statements that he admittedly drafted. This case therefore differs substantially from the facts in *Janus*, where only one entity, the investment fund, filed the prospectus that contained the allegedly false statements. When a statement does identify an entity, the Court explained that "attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by . . . the party to whom it is attributed." *Id.* at 2302. The Court placed importance on whether "anything on the face of the prospectuses indicate[d] that any statements therein came from [defendant]." *Id.* at 2305.

Here, Fillet, as President of Riderwood, and Riderwood itself were conspicuously displayed in the Term Sheet and listed prominently in more than one location as the sole and exclusive marketing agent for the offering. (RP 906, 909.) In *SEC v. Carter*, the court found sufficient for purposes of *Janus* the SEC's allegations of attribution to a defendant of misleading press releases that the defendant allegedly reviewed and approved and where he was listed as a contact person. No. 10 C 6145, 2011 U.S. Dist. LEXIS 136599, at *3-4, *6-7 (N.D. Ill. Nov. 28, 2011). Notably here, Fillet and a managing director of Riderwood are the only contact persons listed for the offering. (RP 909.)

While courts interpreting *Janus* have differed on whether a party's inclusion on an offering document cover page is sufficient to allege Rule 10b-5(b) liability,[10] the NAC's findings are consistent with other court decisions that have addressed the issue of whether underwriters can be held primarily liable under Rule 10b-5(b) for misstatements contained within offering materials which are attributable to the underwriter.[11] *See, e.g.*, *Scott v. ZST Digital Networks, Inc.*, 896 F. Supp. 2d 877, 890-91 (C.D. Cal. 2012) (holding that plaintiff had sufficiently alleged Rule 10b-5 liability against an underwriter whose name was "featured prominently on the offering documents," who authored the misstatements, and who was alleged to be "the architect of the fraud"); *In re Nat'l Century Fin. Enters.*, 846 F. Supp. 2d 828, 861-62 (S.D. Ohio 2012) (determining that a private placement memorandum ("PPM") can be a "shared product" between the issuer and the underwriter); *In re Allstate Life Ins. Co. Litig.*, CV-09-8174-PCT-GMS, 2012 U.S. Dist. LEXIS 7678, at *18-19 (D. Ariz. Jan. 23, 2012) (permitting a Rule 10b-5(b) claim where the names of the underwriters were featured prominently on the first page of the PPM's official statements). In *National Century*, the PPM prominently displayed the underwriter's

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[10] *See, e.g.*, *In re Optimal U.S. Litig.*, 10 Civ. 4095 (SAS), 2011 U.S. Dist. LEXIS 119141, at *23-24 (S.D.N.Y. Oct. 14, 2011) (finding defendant's inclusion on the cover page of fund explanatory memoranda "alongside several other support professionals—including auditors, lawyers and custodians" was insufficient to establish Rule 10b-5(b) liability under *Janus*).

[11] FINRA has reminded brokers, such as Fillet, who market and sell private placements of securities that they are obligated to conduct a reasonable investigation of the issuer and the securities recommended in offerings. *See FINRA Regulatory Notice 10-22*, 2010 FINRA LEXIS 43, at *1 (Apr. 2010). When Fillet recommended an investment in the CAC/FAO Sweet Shoppes private placement, he in effect represented to Malkin "that a reasonable investigation has been made and that [the] recommendation rests on the conclusions based on such investigation." *Hanly v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969). This obligation to investigate is similar to the obligations of underwriters. Thus, the cases discussed above related to underwriters are persuasive authority as to Fillet's liability post-*Janus*. Moreover, Fillet was expected to deal fairly with Malkin, and any sales efforts undertaken were required to be within the ethical parameters of FINRA's rules. *See* NASD Rule 2110; NASD IM-2310-2.

name on front pages and informed potential investors that the underwriter was "'specifically designated' to make representations about the [investment]." 846 F. Supp. 2d at 861. The court determined that the evidence showed that the underwriters played a role in drafting and preparing the PPM and exercising control over the content, thereby creating a triable issue of whether the underwriter was liable for misrepresentations in the PPM. *Id.*

In addition, Fillet was the maker of his own misrepresentations to Malkin in the context of marketing the offering to Malkin through the Term Sheet and the January 2008 meeting with him. Importantly, Fillet does not deny that he made oral representations to Malkin about the offering at the January 2008 meeting with him that coincided with those in the Term Sheet. Fillet in his capacity as the sole and exclusive marketing agent had authority to speak and "made" them for purposes of *Janus*.

Fillet blames Sloan for disseminating the Term Sheet to Malkin, which Fillet claims was only a draft and "contrary to [his] explicit directions." (Br. at 1, 2.) The Hearing Panel, however, found unconvincing Fillet's testimony regarding the Term Sheet being in draft form. (RP 1208-09.) An initial fact finder's assessments of credibility deserve deference based on "hearing the witnesses' testimony and observing their demeanor." *Dane S. Faber*, 57 S.E.C. 297, 307 (2004). Credibility determinations by the fact-finder can be overcome only where the record contains "substantial evidence" for doing so, which is not the case here. *Jay Houston Meadows*, 52 S.E.C. 778, 784 (1996), *aff'd*, 119 F.3d 1219 (5th Cir. 1997).

The NAC sustained the Hearing Panel's credibility determination and noted that there were ample reasons to question Fillet's credibility. (RP 1453.) Fillet asserted that he sent the documents to Sloan's lawyer to review, but he could not provide evidence to substantiate this claim. (RP 724, 756-58.) None of the documents indicate that they were drafts or preliminary

versions, and Fillet claimed he did not keep the original drafts or any copies. (RP 723, 756-59, 769.) Further undercutting Fillet's credibility are his new assertions that he "advised" Sloan that he should not use the Term Sheet and Sloan did so contrary to Fillet's directions. (Br. at 1.) These assertions are without support and at odds with Fillet's and Malkin's testimony at the hearing below.[12] Fillet admitted that he knew when he drafted the Term Sheet that it would be given to potential investors in the CAC/FAO Sweet Shoppes offering, and he was aware that Malkin received it. (RP 720-21, 724, 781.) The record shows that Malkin received the version that Fillet drafted and dated January 14, 2008. (RP 906-17.) As Malkin testified, Fillet communicated directly with him at the January 16, 2008 meeting where Fillet made representations to him about the offering that ultimately coincided with those in the Term Sheet. (RP 595-97, 604, 653, 656.) Once Fillet learned that Malkin received the Term Sheet, he did nothing to determine whether the version that Malkin received was substantively the same as the version Fillet knew was inaccurate. (RP 724, 730, 781.) Instead, Fillet's actions were consistent with an expectation that the Term Sheet that he wrote would be disseminated to investors, which further supports the finding that Fillet had authority over the statements.[13] *See, e.g.*, *SEC v. Daifotis*, 874 F. Supp. 2d 870, 879 (N.D. Cal. 2012) (finding that speaker of statements with

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[12] Equally without record support is Fillet's new assertion that the Term Sheet was being "reviewed by numerous parties" and any one of them could have given the document to Malkin. (Br. at 2.)

[13] Fillet erroneously claims that there is no dispute as to certain facts. (Br. at 1.) For example, Fillet claims that the Term Sheet was for internal use only until Sloan's attorney approved it and was further reviewed by Riderwood; that the statements contained in the Term Sheet were "preliminary" and "forward-looking"; and that he advised Sloan not to use the "preliminary" Term Sheet. (*Id.*) These self-serving statements are an incredible work of fiction and have no support in the record. In reality, as the discussed above, Fillet expected that the Term Sheet would be used to solicit investors as it was here with Malkin. (RP 720-21, 724.)

intent and reasonable expectation that statement would be relayed to investors is the maker of a statement).

Throughout his brief, Fillet concentrates upon blaming Sloan. (Br. at 1-4.) That Sloan likewise may have made misrepresentations to Malkin is not relevant to Fillet's liability. *Cf. Central Bank of Denver, N.A., v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994) (explaining that in "any complex securities fraud . . . there are likely to be multiple [primary] violators"), *superseded in part on other grounds by* 15 U.S.C. § 78t(f), (e). Fillet nevertheless protests that because he did not give Malkin the Term Sheet, did not arrange for the January 2008 meeting, and did not meet or speak with Malkin after that meeting, any of his purported malfeasance is too attenuated to trigger liability. (Br. at 1, 2, 4.) This argument ignores the relationship of Fillet to Sloan and the issuers.[14] The NAC correctly found that the engagement agreement between Riderwood and CAC established that Fillet had authority over the Term Sheet statements that he drafted.[15] (RP 1452-53.) Fillet was authorized to speak on behalf of CAC as illustrated by his contractual obligations under the engagement agreement to perform

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[14] It is also contrary to the record evidence. Fillet and Malkin both testified that Fillet spoke again with Malkin after the January 16, 2008 meeting. (RP 607-08, 635-36, 729-30.)

[15] Fillet claims that he terminated the engagement agreement "prior to the proposed fund raising campaign" and once he learned of Sloan's full criminal background. (Br. at 1-2.) Fillet's own testimony and his actions disprove this claim. First, Fillet admitted that there was no documentation to evidence termination of this agreement. (RP 746.) Second, consistent with his ongoing obligation to provide services pursuant to the engagement agreement, Fillet drafted the Term Sheet and dated it January 14, 2008. (RP 719-20, 906.) Two days later, on January 16, 2008, Fillet met with Malkin to solicit his investment. (RP 593, 652, 721.) Third, Fillet continued to work with Sloan after Malkin invested in the offering and Fillet knew of Sloan's unlawful past. (RP 761-65.) Fillet testified that he agreed to continue to help Sloan "negotiate with various investors and lenders" and even create talking points for him to assist in presentations if Sloan found investors. (RP 761-62, 764.) Contrary to Fillet's assertion, the NAC found he "induced [Malkin's] purchase of a security by means of fraud and deception." (RP 1457.)

due diligence, draft the Term Sheet, and serve as placement agent for the offering. (RP 717, 858.) Fillet and Sloan both may be deemed to have made misrepresentations to Malkin over which they had ultimate authority. In *SEC v. Pentagon Capital Mgmt. PLC*, the Second Circuit determined that both an investment advisor and its CEO were the makers of false statements despite not communicating directly with defrauded mutual funds when defendants controlled the content of the communications and orchestrated the fraudulent misconduct. 725 F.3d 279, 286-87 (2d Cir. 2013).

The evidence and relevant precedent supports that NAC's findings that Fillet was the maker of the misstatements that defrauded Malkin.

3. Fillet's Misstatements and Omissions Were Material

The NAC also correctly found that several categories of information related to the CAC/FAO Sweet Shoppes offering that Fillet either misrepresented or withheld were unquestionably material.

The Supreme Court held in *Basic* that if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision, the information is material. 485 U.S. at 231-32, 240. In the case of an omission, materiality turns on whether "the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* at 231-32.[16]

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[16] Fillet quibbles with the legal precedent that FINRA relied upon in its decision to find him liable for defrauding Malkin. (Br. at 3-4 (citing *Basic*, *De Kwiatkowski*, *Abbondante*, *Faber*, *Hasho*, *Morrow*, and *Cipriano*).) Fillet even goes so far as to accuse FINRA of taking "advantage" of Fillet's pro se status and relying purportedly on faulty legal constructs. (Br. at 3-4 (discussing *De Kwiatkowski*).) As the NAC decision illustrates, however, the legal propositions found in these cases support the NAC's findings against Fillet and remain relevant

[Footnote continued on next page]

The "reasonable investor" standard is an objective one. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445 (1976).

a. Misrepresentations

First, Fillet misrepresented that CAC was a nationally operating company. (RP 907.) In actuality, CAC was nothing more than a shell company with no assets or operations housed in an accountant's office. (RP 717, 729, 770, 907.) This was material information. "In a corporate setting, the most obviously material information would be facts concerning the issuer, the corporation." *SEC v. Murphy*, 626 F.2d 633, 643 (9th Cir. 1980). Thus, CAC's operating status and financial condition are material facts that a reasonable investor would consider pertinent to an investment decision. *See id.*; *Riedel v. Acutote of Colorado LLP*, 773 F. Supp. 1055, 1063 (S.D. Ohio 1991) ("[A] company's financial condition, solvency, and profitability [are] clearly material." (Internal quotations omitted.)).

Second, with respect to FAO Sweet Shoppes, Fillet misrepresented in the Term Sheet that FAO Sweet Shoppes operated "under a global license from FAO Schwarz and the FAO Family Trust." (RP 907.) In truth, Fillet had no basis for these statements at the time when, as Fillet well knew, FAO Sweet Shoppes was merely a concept until it secured the necessary license from

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[cont'd]

law. For example, the NAC quoted from these cases to explain a broker's duty not to mislead when making representations about a security and the requirement to disclose material adverse facts. (RP 1449-50.) The NAC specifically quoted from the Second Circuit's decision in *De Kwiatkowski* to support that Fillet had a duty to disclose material information fully and completely when recommending that Malkin invest in the offering. (*Id.*) This proposition remains authoritative precedent. *See De Kwiatkowski v. Bear, Sterns & Co.*, 306 F.3d 1293, 1302 (2d Cir. 2002). Fillet cannot escape liability by asserting that the NAC relied upon faulty case law.

FAO and the FAO Family Trust. (RP 726-29.) A reasonable investor would view as important the fact that the success of the primary business venture was contingent upon receipt of a license that had not been obtained. *See, e.g., Glodek*, 2009 SEC LEXIS 3936, at *9-10, *15-16 (representations about issuer's imminent listing on stock exchange was materially misleading when issuer had not filed necessary listing application); *Thomas J. Fittin, Jr.*, 50 S.E.C. 544, 546-47 (1991) (finding the characterization of certain drilling programs as involving developmental wells, when they were actually exploratory, to be materially misleading); *Richard J. Buck & Co.*, 43 S.E.C. 998, 1005-06 (1968) (company's failure to inform investors that negotiations with electronic companies for the sale or licensing of its product were producing negative results was materially misleading in light of other optimistic statements), *aff'd sub nom. Hanly*, 415 F.2d at 589.

Fillet argues that these representations in the Term Sheet were forward looking and drafted in a way that contemplated certain contingencies occurring in the future. (Br. at 4.) A review of the exact language used in the Term Sheet shows that Fillet is incorrect and that these statements are concrete misrepresentations of CAC's and FAO Sweet Shoppes' status. (RP 907.) For example, the Term Sheet states that FAO "Sweet Shoppes *operates* under a global license from FAO," rather than stated in the forward-looking manner of "will operate" as Fillet suggests. (RP 907 (emphasis added).) Fillet was required to disclose material adverse facts, including that key events had not occurred. *See Richard H. Morrow*, 53 S.E.C. 772, 780-81 (1998).

b. Omissions

Fillet failed to disclose to Malkin that Sloan, the intended CEO of CAC and FAO Sweet Shoppes, previously had been convicted of possessing stolen property and had an extensive

criminal history. (RP 609, 611, 722-23.) An omission is actionable under the securities laws when a person is under a duty to disclose. *See Basic*, 485 U.S. at 239 n.17. Because Fillet made statements in a securities transaction, he therefore assumed a duty to speak truthfully and completely about that transaction, which included disclosing Sloan's criminal history. *See Rubin v. Schottenstein, Zox & Dunn*, 143 F.3d 263, 269 (6th Cir. 1998) (en banc). Sloan was held out as the steward of the enterprise and the person integral to the success of the offering. (RP 591, 908.) Indeed, Malkin understood that FAO was relying on Sloan to run the business and on his judgment. (RP 628-29.) Sloan's background generally, and his felony theft conviction specifically, was "information crucial to the investment decision . . . concerning the entity . . . responsible for the success or failure of the enterprise" and therefore material. *See Murphy*, 626 F.2d at 643; *see also SEC v. Electronics Warehouse, Inc.*, 689 F. Supp. 53, 66 (D. Conn. 1988) ("An indictment for mail fraud of the president and founder of the issuing corporation was a fact that any reasonable investor would have considered important in making the decision to invest in [the issuer]."); *Gallagher & Co.*, 50 S.E.C. 557, 564 & n.16 (1991) (finding that indictment for mail fraud of person essential to the issuer's success was a material fact requiring disclosure before selling the stock to investors), *aff'd*, 963 F.2d 385 (11th Cir. 1992). Moreover, Malkin testified that had he known of Sloan's felonious past, he would not have invested in the offering. (RP 655-57.)

Fillet also unreasonably failed to discover and disclose the full extent of Sloan's wide-ranging history. Riderwood's due diligence on Sloan consisted of running a misspelled Pacer search of "Alan Sloan" and searching the SEC's website for "TriBakery Capital," which Fillet described as CAC's predecessor. (RP 718-19, 945-51.) Fillet and Riderwood undertook no further research of Sloan's background. Had he conducted a reasonable investigation into

Sloan's background, Fillet would have learned that Sloan had been disbarred from practicing law as a result of a 1987 felony conviction for offering a false affidavit to a New York court. (RP 779, 1162.) Prior to being disbarred, Sloan was disciplined for violating various New York attorney disciplinary rules related to converting client funds. (RP 1162.) Sloan also had hundreds of thousands of dollars in civil judgments and liens against him and had filed for bankruptcy in 2003. (RP 955-95.)

Fillet asserts that he told Sloan to disclose his criminal past to Malkin and FAO and that Sloan purportedly told him that he did this. (Br. at 2.) Yet as discussed above, the record is clear that Sloan did not disclose his past to Malkin or FAO. (RP 609, 611, 722-23.) Fillet's effort to distance himself from his duty of disclosure is unreasonable. Fillet was not simply a broker who should have known better. Fillet was the broker charged with the obligation to conduct a reasonable investigation of the issuer he was recommending to Malkin and to make material disclosures. *See FINRA Regulatory Notice 10-22*, 2010 FINRA LEXIS 43; *supra* note 11. Even if Sloan was in part to blame, that fact does not absolve Fillet of his own responsibility to be accurate and complete in his material disclosures to Malkin. *See Justine Susan Fischer*, 53 S.E.C. 734, 741 & n.4 (1998) (holding that "[a] broker has responsibility for his . . . own actions and cannot blame others for [his] own failings").

4. Fillet Acted with Scienter

Fillet also acted with scienter when he induced Malkin's purchase of securities through fraudulent and deceptive means. The Supreme Court has defined scienter as the "intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.7 (1976).

Scienter may be established by a showing that the respondent acted intentionally or recklessly.[17] *See Tellabs*, 551 U.S. at 319 n.3; *Ottman v. Hanger Orthopedic Group*, 353 F.3d 338, 343 (4th Cir. 2003). In the case of a material omission, "scienter is satisfied where, [as here,] the [respondent] had actual knowledge of the material information." *GSC Partners CDO Fund v. Washington*, 368 F.3d 228, 239 (3d Cir. 2004).

Fillet's fraudulent intent is established because Fillet was aware of and responsible for the inaccuracies in the Term Sheet and was at least reckless in allowing the Term Sheet to be used to sell securities to Malkin. Fillet admittedly prepared the Term Sheet and was responsible for the Term Sheet's misrepresentations. (RP 719-20, 726-29, 906-09.) Fillet's role as Sloan's investment banker charged with conducting due diligence and orchestrating the CAC/FAO Sweet Shoppes offering, coupled with his preparation of the Term Sheet, demonstrate that Fillet was aware when he drafted the Term Sheet that the issuers were neither operating companies nor national in scope. (RP 717, 719-20, 726-29, 858.) In addition, Fillet knew from his due diligence that the Term Sheet did not accurately represent the then-current status of FAO Sweet

[17] Fillet argues that FINRA was required to "allege and prove with overwhelming evidence that [he] acted with scienter" and cites to the Supreme Court's discussion in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007), articulating the pleading standard in the Private Securities Litigation Reform Act ("PSLRA"). (Br. at 3-4.) As discussed above, FINRA is required to prove each element of fraud, including scienter, by a preponderance of the evidence, and it did so in this case. *See supra* Part IV.A & note 7. Fillet also is incorrect that the PSLRA pleading standard applies to FINRA. By its terms, the PSLRA applies only to private parties and does not apply to disciplinary actions brought by a securities regulator. *See* 15 U.S.C. § 78u-4(a)(1) ("The provisions of this subsection shall apply in each private action arising under this chapter"); *Tellabs*, 551 U.S. at 321. Whether Malkin has a private claim against Fillet is not an issue here. Malkin's claims against Sloan are likewise irrelevant to Fillet's liability. (Br. at 3.)

FINRA Rule 9212 sets forth the pleading requirements for Enforcement's allegations, and requires that the complaint "specify in reasonable detail the conduct alleged to constitute the violative activity and the rule, regulation, or statutory provision the Respondent is alleged to be violating or to have violated." Enforcement clearly met these standards. (RP 1-14.)

Shoppes' licensing agreement with FAO. (RP 726-27, 729.) Fillet was at least reckless and should have made the proper disclosures. *See DWS Sec. Corp.*, 51 S.E.C. 814, 818 & n.15 (1993) (finding scienter when firm vice president who also served as issuer's chief financial officer participated in the preparation of private placement memoranda that described uses of proceeds that did not occur).

Fillet's intent is also evidenced by the fact that he did not mark the Term Sheet as "draft" or ensure that Sloan did not provide it to prospective investors. Fillet was aware when he drafted the Term Sheet and when he met with Malkin that Sloan planned to use the Term Sheet to obtain investors to finance the offering. (RP 720-21, 723-24.) Fillet worked with Sloan to solicit Malkin's investment in the offering, including by drafting the inaccurate Term Sheet and releasing it to Sloan. Fillet knew what he had written in the Term Sheet was inaccurate and misleading. He nonetheless did nothing to prevent its use to sell securities to investors. These facts support the NAC's finding that Fillet was at least reckless. *See Tretiak*, 56 S.E.C. at 224-25 (broker who was a selling agent for issuer was at least reckless in failing to ensure that prospectus that he drafted, signed, and used in selling securities was accurate).

Fillet's fraudulent intent is demonstrated further by his concealment. Fillet knew that Sloan was a felon convicted of theft and concealed this material fact from Malkin both in the Term Sheet and during the January 16, 2008 meeting. (RP 609, 611, 722-23.) Fillet cites to the purported brevity of the January 2008 meeting and the amount of time between that meeting and Malkin's investment as somehow showing that he had no intent to defraud Malkin. (Br. at 2.) None of these facts offer Fillet a basis for making the statements in the Term Sheet, but, instead, serve to emphasize Fillet's fraudulent intent. He had multiple opportunities to clarify the true status of the issuers and disclose Sloan's criminal past to Malkin that Fillet knew since late 2007.

See, e.g., *DWS Sec.*, 51 S.E.C. at 818 n.15 (finding knowing or reckless conduct when proper disclosures not made timely after discovery). Instead, Fillet kept these facts to himself and increased the chance that his marketing of the offering would succeed in attracting investors.

Fillet contends that he somehow lacked scienter because "no one at Riderwood received or . . . facilitated collection of [Malkin's] funds," and "no one at Riderwood was paid" for defrauding Malkin. (Br. at 2, 4.) This argument is unsound. Fillet testified that Riderwood received between $20,000 and $30,000 for its role in marketing the CAC/FAO Sweet Shoppes offering. (RP 736.) Fillet and Riderwood also stood to receive a percentage of the gross proceeds raised in the offering. (RP 859.) The fact that Malkin did not pay Fillet or Riderwood directly is inconsequential to Fillet's liability for playing an instrumental role in orchestrating the fraudulent investment. Nor is it relevant that Malkin's subscription agreement was not "reviewed," "counter-signed," or purportedly funded "in compliance with the Term Sheet."[18]

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[18] That neither Sloan nor anyone at Riderwood "counter-signed" Malkin's subscription agreement does not preclude Fillet's liability for fraud under the Exchange Act or FINRA rules. Fillet's marketing of the offering to Malkin resulted in his investment. Fillet failed to link his recommendation of investment in the private placement with his knowledge that CAC was not an operating company, that FAO Sweet Shoppes was a concept that could not move ahead without essential licensure from FAO and the FAO Family Trust that it had not received, and that the issuers' appointed CEO was a convicted felon who served jail time for grand theft auto. Armed with a wealth of knowledge of the true status of CAC and FAO Sweet Shoppes and Sloan's felonious past, Fillet chose to keep to himself these critical facts and proceed on the course of conduct that offered him the potential for the greatest financial benefit. Importantly, Malkin understood that he was investing in a securities offering. *Cf. Marine Bank v. Weaver*, 455 U.S. 551, 554 n.2 (1982) (pledge of securities is equivalent to a sale for purposes of antifraud provisions of the Exchange Act); *First Nat'l Bank of Las Vegas v. Estate of Russell*, 657 F.2d 668, 673 n.16 (5th Cir. 1981) (explaining that the fact that broker-dealer never owned the securities does not preclude protection of the plaintiff by the federal securities laws when the plaintiff was an actual party to the securities transaction and, but for the broker-dealer's fraud, would have become an actual purchaser); *supra* note 8. Contrary to Fillet's assertions, Malkin's investment did not become "NULL AND VOID" when only Malkin signed the subscription agreement. (Br. at 2-3.)

(Br. at 2-3.) The pertinent points are that Malkin signed the agreement and invested $150,000 in the securities offering that Fillet fraudulently marketed to him. (RP 917-919.)

Fillet makes other irrelevant assertions in an effort to transfer blame to Malkin and show that he lacked scienter. (Br. at 2-4.) The Commission should reject Fillet's ongoing efforts to undermine the victim of Fillet's fraud when none of these assertions obviated the need for Fillet to disclose accurately and completely the materials facts that he knew. *See Fischer*, 53 S.E.C. at 741 n.4; *Lester Kuznetz*, 48 S.E.C. 551, 554 (1986) (stating that a customer's investment experience does not give a representative "license to make fraudulent representations"), *aff'd*, 828 F.2d 844 (D.C. Cir. 1987).

5. Fillet Violated FINRA's Antifraud Rule

The Commission should also affirm the NAC's finding that Fillet's misconduct in misleading Malkin independently violated FINRA's antifraud rule, NASD Rule 2120. (RP 1456-57.) Rule 2120 prohibits members from effecting any transaction in, or inducing the purchase or sale of, any security "by means of any manipulative, deceptive or other fraudulent device or contrivance." The NAC explained that Rule 2120, while generally construed as similar to Exchange Act § 10(b) and Exchange Act Rule 10b-5, is broader than Exchange Act Rule 10b-5. (RP 1456-57.); *see Dep't of Enforcement v. Kesner*, Complaint No. 2005001729501, 2010 FINRA Discip. LEXIS 2, at *19 n.23 (FINRA NAC Feb. 10, 2010). Unlike misconduct alleged under Exchange Act Rule 10b-5(b), a violation of Rule 2120 does not require a finding that Fillet was the "maker" of misstatements. The text of Rule 2120 relies upon the phrase "by means of," in parallel to the text of Securities Act of 1933 ("Securities Act") § 17(a)(2), rather than "make"

as used in Rule 10b-5(b).[19] Thus, the language of Rule 2120 is critically different than the language found in Rule 10b-5(b).[20] *See, e.g.*, *Abbondonte*, 58 S.E.C. at 1103 (setting forth differing elements of Exchange Act Rule 10b-5(b) and NASD Rule 2120). In interpreting the antifraud provisions of the Exchange Act and Securities Act § 17(a), courts have determined that § 17(a)'s language to obtain money or property "by means of" an untrue statement plainly covers a broader range of activity than Rule 10b-5's "make." *See SEC v. Stoker*, 865 F. Supp. 2d 457, 465 (S.D.N.Y. 2012). Courts further have found dispositive that "the word 'make,' which is the very thing the Supreme Court was interpreting in *Janus*, is absent from the operative language of Section 17(a)." *Daifotis*, 2011 U.S. Dist. LEXIS 83872, at *14-15 (comparing the texts of Rule 10b-5 and § 17(a)).

Accordingly, under Rule 2120, Fillet is liable because he induced the purchase or sale of a security through the "use" of a false statement, both through the Term Sheet and his oral statements. Fillet had special obligations to fulfill when offering shares of a private placement for sale. *See FINRA Regulatory Notice 10-22*, 2010 FINRA LEXIS 43. The facts are clear that Fillet breached his duty as a broker not to mislead Malkin in connection with the CAC/FAO Sweet Shoppes offering.

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[19] Section 17(a)(2) makes it unlawful in the offer or sale of securities "to obtain money or property by means of any untrue statement" or omission of a material fact.

[20] Private actions are unavailable under Rule 2120, which is another compelling distinction from Exchange Act Rule 10b-5 and further supports the NAC's conclusion that *Janus* is not dispositive as to Rule 2120 actions. *Cf. SEC v. Daifotis*, No. C 11-00137 WHA, 2011 U.S. Dist. LEXIS 83872, at *14-15 (N.D. Cal. Aug. 1, 2011) ("*Janus*'s stringent reading of the word 'make' followed from the Court's prior decisions limiting the scope of implied private rights of action under Rule 10b-5 . . . . The same rationale does not apply in the context of Section 17(a) because there is already no implied private right of action for Section 17(a) claims.").

Fillet played a key role in inducing Malkin to invest in the offering. Fillet was retained as placement agent to find investors and raise money for the offering and, as Malkin testified, Fillet added "credibility" to Sloan as his investment banker. (RP 654, 606.) In his role as the CEO of a broker-dealer, Fillet attended the January 16, 2008 meeting with Sloan for the purpose of pitching the offering to Malkin. Fillet knew many of the material facts that were represented to Malkin at the meeting were inaccurate at that time. Most significantly, Fillet drafted the fraudulent Term Sheet that Malkin received. Fillet was well aware that the Term Sheet contained untrue statements, but he did nothing to prevent Malkin from receiving the document. Moreover, Fillet purposely withheld from Malkin his knowledge of Sloan's criminal past—a past that ultimately doomed the offering. The Commission should uphold the NAC's finding that Fillet, acting with scienter, induced Malkin's purchase of a security by means of fraud and deception, in violation of NASD Rule 2120.[21]

* * * * *

The NAC properly concluded that Fillet engaged in fraud by using materially misleading offering materials to market securities in a private placement, in violation of Exchange Act §

[21] Once again relying on an erroneous standard of proof, Fillet argues that the NAC improperly shifted the burden of proof from Enforcement to him. (Br. at 3-4.) Enforcement carried the burden of proving fraud by a preponderance of the evidence. *See supra* Part IV.A & note 7. Here, Enforcement produced evidence of Fillet's material misrepresentations and omissions and that Fillet acted with scienter. In mounting his defense, Fillet had the burden to marshal persuasive evidence that refuted Enforcement's evidence, nothing more. *See James B. Hovis*, Exchange Act Release No. 55562, 2007 SEC LEXIS 604, at *28 (Mar. 30, 2007) (finding that, once Enforcement presented evidence of the allegations, the burden of going forward shifted to respondents to refute the evidence). Fillet was unable to meet his burden and the NAC properly found him liable for fraud.

10(b), Exchange Act Rule 10b-5, NASD Rules 2120 and 2110, and IM-2310-2.[22] The Commission should affirm the NAC's findings of violation.

B. Fillet Falsified Firm Records and Provided Them to FINRA

The Commission should affirm the NAC's findings that Fillet backdated his purported supervisory review related to 10 variable annuity transactions for seven Riderwood customers and then provided these falsified documents to FINRA. On appeal to the Commission, Fillet states that he is not asking the Commission to review that portion of the NAC's decision and therefore does not contest the NAC's findings that he violated NASD Rules 3110 and 2110.[23] (RP 1495; Br. at 5.) It is not surprising that Fillet would like the Commission to gloss over this aspect of his misconduct. The record evidence overwhelmingly supports these findings and

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[22] Fillet's misrepresentations to Malkin also independently violate NASD Rule 2110. When Fillet participated in the securities offering to investors, he incurred the "duties under the NASD's Rules to treat . . . investors in accordance with high standards of commercial honor and just and equitable principles of trade and to refrain from fraud." *Wilshire Discount Sec., Inc.*, 51 S.E.C. 547, 550 (1993). Brokers such as Fillet are expected to deal fairly with the public, and any sales efforts undertaken must be within the ethical parameters of FINRA's rules. *See* NASD Rule 2110; NASD IM-2310-2. The Commission has long held that to impose liability for violating NASD Rule 2110, or other rules requiring just and equitable principles of trade, it is sufficient to find "bad faith or unethical conduct." *See Thomas W. Heath III*, Exchange Act Release No. 59223, 2009 SEC LEXIS 14, at *13 (Jan. 9, 2009), *aff'd*, 586 F.3d 122 (2d Cir. 2009); *Chris Dinh Hartley*, 57 S.E.C. 767, 773 n.13 (2004). A broad array of conduct can violate Rule 2110, including when a broker breaches his duty to an investor, as occurred here by making misrepresentations and omissions. *See Faber*, 57 S.E.C. at 305-06; *Dep't of Enforcement v. Timberlake*, Complaint No. C07010099, 2004 NASD Discip. LEXIS 11, at * 16 (NASD NAC Aug. 6, 2004) ("It is axiomatic that a broker who makes material misrepresentations and omissions to customers is engaging in unethical conduct."). The Commission can uphold the NAC's findings of liability on this basis alone.

[23] In the proceedings below, the NAC thoroughly evaluated the question of whether Fillet backdated his supervisory approval of customers' variable annuity documents and passed these falsified documents off to FINRA as authentic and thereby violated NASD Rules 3110 and 2110. When the Commission considers this aspect of Fillet's application for review, we also direct the Commission to the NAC's analysis. (RP 1447-48, 1458-59, 1463-65.)

illuminates Fillet's history of acting inconsistent with the high ethical demands of a representative in the securities industry.

NASD Rule 3110 requires that member firms keep books and records as prescribed in Exchange Act Rules 17a-3 and 17a-4. Individuals may violate NASD Rules 3110 and 2110 when they fail to comply with Exchange Act Rules 17a-3 or 17a-4, or are otherwise responsible for creating and maintaining inaccurate books and records. *See N. Woodward Fin. Corp.*, Exchange Act Release No. 60505, 2009 SEC LEXIS 2796, at *23 (Aug. 14, 2009).

Fillet, as he concedes, falsified customer new account forms, applications, and acknowledgement forms related to 10 variable annuity transactions that Riderwood executed for seven customers. (RP 715-16, 1003-08, 1011-16, 1017-22, 1023-28, 1029-32, 1033-39, 1041-44, 1045-58, 1059-70, 1075-87, 1091-1103; Br. at 5.) Fillet undeniably falsified the variable annuity documents by signing his name in those sections of the documents requiring his supervisory approval and then backdating the documents to make it appear that he had conducted a timely supervisory review. The inaccurate dates gave the false impression that Fillet had signed the forms close in time with when the variable contracts were written, even though the transactions had occurred in most cases several months earlier. By falsifying customer forms related to securities transactions that Riderwood executed, Fillet caused Riderwood to enter false information in its books or records.

Fillet also acted antithetically to NASD Rule 2110's requirement that members observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business, both by backdating the documents and by providing these falsified documents to a FINRA examiner. Fillet's attempt to mislead FINRA is conduct unquestionably inconsistent with Rule 2110. *See Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006); *Brian L. Gibbons*, 52

S.E.C. 791, 795 (1996) ("Providing misleading and inaccurate information to the NASD is conduct contrary to high standards of commercial honor. . . .").

Based on these principles, the Commission should sustain the NAC's findings that Fillet falsified Firm records by backdating them and that he provided these inaccurate documents to FINRA, in violation of NASD Rules 3110 and 2110.

C. The Sanctions that the NAC Imposed on Fillet Are Neither Excessive nor Oppressive

The sanctions that the NAC crafted in this case are appropriate given the gravity of Fillet's conduct and are neither excessive nor oppressive. *See* 15 U.S.C. § 78s(e)(2). The Commission should affirm the sanctions. As detailed in the NAC's decision in this matter, the NAC, after carefully considering the sanction ranges suggested in the applicable Guidelines and applying the aggravating and mitigating factors, found that the factors that Fillet presented in mitigation were insufficient to sustain lesser sanctions.

1. An 18-Month Suspension and $10,000 Fine Are Appropriate for Fillet's Fraud

The NAC suspended Fillet for 18 months in all capacities and fined him $10,000 for his fraudulent misrepresentations and omissions in connection with the CAC/FAO Sweet Shoppes securities offering. In modifying the sanctions imposed by the Hearing Panel, the NAC carefully weighed the relevant factors contained in the Guidelines and found that the seriousness of Fillet's misconduct warranted increasing the suspension from six months to 18 months. (RP 1461-63.) The Commission should affirm these sanctions.

The NAC considered the Guidelines for intentional or reckless misrepresentations of material facts. (RP 1461-62.) The Guidelines recommend that the adjudicator should consider fining the responsible individual between $10,000 and $100,000 and suspending him for 10 business days to two years. *FINRA Sanction Guidelines* 88 (2013), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf (hereinafter "*Guidelines*"). The Commission in its review of sanctions gives weight to whether the sanctions are within the allowable sanction range under the Guidelines. *See Howard Braff*, Exchange Act Release No. 66467, 2012 SEC LEXIS 620, at *18-19 (Feb. 24, 2012). The $10,000 fine and 18-month suspension of Fillet are well within the parameters of the Guidelines and consistent with these recommendations.

The Guidelines also recommend consideration of several general factors in determining the proper remedial sanction.[24] *Id.* The NAC determined in light of these factors that minimal sanctions were unwarranted given the circumstances of this case and that a longer suspension than imposed by the Hearing Panel was necessary. (RP 1461-63); *see also Glodek*, 2009 SEC LEXIS 3936, at *21 ("[FINRA] is not required to state why a lesser sanction would be insufficient in order to justify the sanction it imposed as being remedial."); *Vincent M. Uberti*, Exchange Act Release No. 58917, 2008 SEC LEXIS 3140, at *24 (Nov. 7, 2008) (emphasizing that fraud "is especially serious and subject to the severest of sanctions"). "If the [NAC]

24 Several relevant factors include whether the applicant acted recklessly; whether the applicant was a factor in customer losses; whether the misconduct resulted in the potential for monetary gain; and whether the applicant accepted responsibility for his misconduct. *See Guidelines*, at 6-7.

determines that sanctions should have been more severe, it is the [NAC's] duty to modify them appropriately."[25] *First Heritage Inv. Co.*, 51 S.E.C. 953, 960 (1994).

The NAC found that Fillet's misconduct was reckless and serious. (RP 1461-62); *Guidelines*, at 7 (Principal Consideration No. 13). The Commission has emphasized that "[r]egistered representatives must not make repeated, reckless, and unfounded misstatements to their customers in connection with the sale of securities, and doing so warrants the imposition of meaningful sanctions." *Glodek*, 2009 SEC LEXIS 3936, at *30.

Fillet disregarded his obligation to supply complete and accurate information to Malkin and prevented Malkin from accurately assessing whether an investment in CAC and FAO Sweet Shoppes was best for him, which was relevant to the NAC's sanctions determination. Investors depend upon the reliability and honesty of their broker's communications. As the NAC highlighted, Malkin viewed Fillet's involvement in the offering as adding credibility to Sloan and through Fillet's involvement in the offering process, Malkin believed that the statements about the issuers were true. (RP 654, 606, 1462) Because the securities industry "presents a great many opportunities for abuse and overreaching, and depends very heavily on the integrity of its participants," a suspension of meaningful duration was necessary to protect investors. *See Bernard D. Gorniak*, 52 S.E.C. 371, 373 (1995).

The NAC also found that Fillet's misconduct was a factor in Malkin's losses and was exacerbated by Fillet's potential for monetary gain. *Guidelines*, at 6-7 (Principal Considerations Nos. 11, 17); (RP 1462-63.) Fillet admitted at the hearing that Riderwood received $20,000-$30,000 from Sloan pursuant to the engagement agreement. (RP 736.) Riderwood also had an

[25] The NAC followed FINRA's rules in increasing Fillet's suspension from six months, as imposed by the Hearing Panel, to 18 months, and Fillet had notice that an increase in sanctions was possible. *See* FINRA Rules 9348, 9349(a); (RP 1225-27, 1237-52).

expectation of additional compensation, including 5% of the outstanding and voting common shares of CAC within 10 days of the closing of the transaction and a percentage of the gross proceeds raised in the offering. (RP 858-59.) Fillet stood to realize financial rewards by marketing the CAC/FAO Sweet Shoppes offering to investors, which potentially clouded his objectivity and encouraged his silence with respect to Sloan's background. An applicant's pecuniary interest is always an important factor to be considered under the Guidelines and, in this case, supports the likelihood that Fillet's objectivity toward the offering was compromised. Based on this factor, the NAC properly increased the duration of the suspension.[26]

For the purposes of sanctions, the NAC gave Fillet some credit for the fact that Malkin was a knowledgeable investor who had direct contact with FAO's then-current CEO Schmults and that Schmults was the person who first made Malkin aware of the CAC/FAO Sweet Shoppes offering. (RP 1462-63.) Undercutting this mitigation, however, was the fact Fillet, who played a central role in obtaining Malkin's investment, elected not to provide accurate and complete facts in his communications with Malkin. (RP 606, 654, 1462.)

Fillet persists in blaming Sloan and Malkin for a situation that was created by his own actions. (Br. at 1-4.) Fillet has made clear that he views his role as tangential to the fraud. (*Id.*) But Fillet cannot blame others for misconduct in which he played a leading role. *See Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *73-74 (Jan. 30, 2009), *aff'd*, 416 F. App'x 142 (3d Cir. 2010); *Guidelines*, at 6 (Principal Consideration No. 2). Fillet's statements during the course of this disciplinary action indicate that he fails to appreciate his

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[26] Fillet argues that "no one at Riderwood was paid" for Malkin's investment in the offering. (Br. at 2, 4.) Fillet again shades the truth. As the record shows, Sloan paid Fillet through Riderwood for his activities pursuant to the engagement agreement and Fillet stood to gain if the offering was successful.

responsibility for his violations and calls into question whether Fillet might repeat his misconduct. *See Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at *64 (Nov. 9, 2012) (finding that applicant's "persistent attempts to deflect blame onto others . . . suggests that he is likely to engage in similar misconduct in the future"); *Raghavan Sathianathan*, Exchange Act Release No. 54722, 2006 SEC LEXIS 2572, at *44 (Nov. 8, 2006) (finding aggravating for purposes of sanctions that applicant repeatedly blamed others for his violative conduct), *aff'd*, 304 F. App'x 883 (D.C. Cir. 2008); *Clyde Bruff*, 53 S.E.C. 880, 887 (1998) (finding continued attempts to shift blame to be "additional indicia of [applicant's] failure to take responsibility for his actions"). Fillet's "continued refusal to acknowledge any wrongdoing" with respect to his role in defrauding Malkin "is a troubling indication that [he] either misunderstand[s his] regulatory obligations or hold[s] those obligations in contempt." *See Robert Conway*, Exchange Act Release No. 70833, 2013 SEC LEXIS 3527, at *41-42 (Nov. 7, 2013).

Fillet made wholly irresponsible misstatements and omissions that amounted to an abdication of his basic responsibilities as a securities professional. Under the circumstances, the 18-month suspension and $10,000 fine imposed upon Fillet are needed to protect the investing public and to deter Fillet from engaging in similar fraudulent conduct in the future.

2. A Two-Year Suspension and $10,000 Fine Are Appropriate for Intentionally Falsifying Firm Records and Providing Them to FINRA

The NAC suspended Fillet for two years and fined him an additional $10,000 for intentionally falsifying customer documents, thereby making inaccurate his Firm's books and records, and knowingly providing these falsified records to FINRA during the course of an examination. (RP 1463-65.) Fillet's actions were nothing short of egregious and exemplify his

willingness to flout regulatory requirements necessary to the proper functioning of the securities industry and protection of the public. The Commission should affirm the NAC's sanctions.

For egregious violations of NASD Rules 3110 and 2110, the Guidelines recommend imposing a fine of $10,000 to $100,000 and suspending the responsible individual for up to two years or imposing a bar. *See Guidelines*, at 29. In cases like this one where the recordkeeping violation is intentional, the NAC has determined that the Guidelines for falsification of documents also apply and serve to broaden the range of permissible sanctions. *See Dep't of Enforcement v. Cohen*, Complaint No. EAF0400630001, 2010 FINRA Discip. LEXIS 12, at *57-60 (FINRA NAC Aug. 18, 2010); *Guidelines*, at 37. For falsification of records, the Guidelines recommend a fine of $5,000 to $100,000 and consideration of a suspension of up to two years or a bar in egregious cases. *Guidelines*, at 37. The sanctions imposed fall well within the recommended ranges set forth in both Guidelines.

Both of these Guidelines direct adjudicators to impose strong sanctions, particularly when the nature of the inaccurate or missing information is especially material. *Guidelines*, at 29, 37. That is exactly what occurred in this case. The NAC found the annuity documents that Fillet backdated were important customer records. (RP 1464.) They are essential for firms to supervise and regulators to review annuity sales activity in order to protect investors. Seven Riderwood customers were deprived of necessary supervisory protections related to their 10 transactions in this case. (RP 1464.) The Commission has emphasized the importance of accurate books and records by describing the recordkeeping rules as the "keystone of the surveillance of broker and dealers." *Edward J. Mawod & Co.*, 46 S.E.C. 865, 873 n.39 (1977), *aff'd*, 591 F.2d 588 (10th Cir. 1979); *see also Comm'n Guidance to Broker-Dealers on the Use of Electronic Storage Media Under the Electronic Signatures in Global and Nat'l Commerce Act*

of 2000 with Respect to Rule 17a-4(f), Exchange Act Release No. 44238, 2001 SEC LEXIS 2761, at *7 (May 1, 2001) (stating that "preserved records are the primary means of monitoring compliance with applicable securities laws, including antifraud provisions and financial responsibility standards"). Accordingly, "[t]he recordkeeping requirements of the securities laws are . . . fundamental requirements imposed on those who wish to engage in the securities business." *See Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 SEC LEXIS 3583, at *58 (Nov. 15, 2013) (internal quotation omitted).

It was Fillet's responsibility as the registered principal overseeing these variable annuity transactions for the Firm to review the trades promptly. (RP 571, 667-68, 710.) Fillet's falsification impeded the Firm's ability to detect and correct the lack of supervision over these transactions. "Assuring proper supervision is a critical component of broker-dealer operations," fundamental to regulatory compliance, and "a predicate to the NASD's regulatory oversight of its members," which is essential to ensuring investor protection. *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33-34 (Dec. 19, 2008); *Charles E. Kautz*, 52 S.E.C. 730, 734 (1996). The NAC appropriately found aggravating that Fillet's backdating of customer documents undermined the accuracy of the Firm's records for which Fillet was responsible, and which were necessary to the Firm's supervision of variable annuity transactions. (RP 1464.)

Despite his admission of misconduct related to the backdating, Fillet throughout these proceedings has attempted to downplay significantly his subterfuge and now contends he did not lie to FINRA. (Br. at 5.) The NAC in determining sanctions accounted for the fact that Fillet acted intentionally when he attempted to deceive FINRA and frustrate its oversight of the Firm. (RP 1464-65.) Fillet deliberately provided the backdated documents to FINRA staff, initially

denied the backdating to FINRA, and gave false on-the-record testimony in an attempt to disguise his misconduct.[27] (RP 997, 1111-1113, 1116-17, 1122-26.) The NAC found Fillet's lack of candor during the initial phases of FINRA's investigation in an effort to conceal his own responsibility to be significantly troubling, and supportive of its sanctions. *See, e.g.*, *Hans N. Beerbaum*, Exchange Act Release No. 55731, 2007 SEC LEXIS 971, at *17-18 (May 9, 2007).

The NAC also correctly found aggravating that this was not an isolated occurrence. *See Guidelines*, at 6-7 (Principal Considerations Nos. 8, 18). Fillet's backdating involved seven customers, 10 transactions, and multiple sets of customer documents. (RP 1464.)

In an effort to explain away his misconduct, Fillet claimed that he did not consider the backdating "that big of a deal" or a rule violation and admitted that he was habitually lax in dating documents. (RP 715-16.) Certainly, a securities professional such as Fillet who had been working in the securities industry for more than three decades would know that falsifying firm documents was improper. *See, e.g.*, *Braff*, 2012 SEC LEXIS 620, at *22 (finding that broker's 22 years of industry experience was further evidence that broker intended to conceal an outside brokerage account). Moreover, "[p]articipants in the securities industry must take responsibility for compliance with regulatory requirements and cannot be excused for lack of knowledge,

[27] When FINRA staff asked Fillet during the on-the-record interview to explain myriad inconsistencies among documents that FINRA received from a Riderwood branch office and from Fillet during the July 2008 on-site examination, Fillet provided unsubstantiated excuses and hollow denials. (RP 1111-1113, 1116-17, 1122-26.) For example, Fillet asserted that documents may have been lost in the mail (RP 1114) or that the faxed documents were not the same copies (RP 1116). And he denied the backdating again and again: "I have never backdated a file during the whole time I was at Riderwood" (RP 1113); "I just don't have a recollection of what happened, . . . we were not in the habit of backdating documents"; "I have no recollection whatsoever that we backdated the document" (RP 1117); "Did you backdate this document? . . . Not to the best of my knowledge" (RP 1122); "No, I did not backdate" (RP 1123); "Did you backdate it? . . . No sir" (RP 1124-26). It was only after Fillet was confronted with overwhelming and incontrovertible evidence of his backdating at the hearing that he admitted to his misconduct. (RP 737-39.)

understanding, or appreciation of these requirements." *Thomas C. Kocherhans*, 52 S.E.C. 528, 531 (1995).

Fillet contends that in other recordkeeping cases other respondents received lighter sanctions. (Br. at 5.) Fillet misapplies the Guidelines and fails to account for the specific circumstances of his misconduct here, which includes deliberately falsifying customer documents, providing them to FINRA as accurate and authentic, and repeatedly lying to FINRA about it. Fillet's comparison of sanctions in other matters also is not relevant or dispositive. *See Christopher J. Benz*, 52 S.E.C. 1280, 1285 (1997), *aff'd*, 168 F.3d 478 (3d Cir. 1998).

Fillet's contention that his misconduct resulted in no customer harm, and specifically that "no customer . . . suffered any additional costs or lower income" and therefore is less serious is unavailing. (Br. at 5.) Fillet's misconduct is no less serious because of the lack of evidence of customer harm. *See Ronald J. Gogul*, 52 S.E.C. 307, 312 n.20 (1995) (finding the fact that no customer complained about an investment was "not persuasive" in support of respondent's argument that sanctions should be reduced). "The absence of monetary gain or customer harm is not mitigating, as our public interest analysis focus[es] . . . on the welfare of investors generally." *Braff*, 2012 SEC LEXIS 620, at *26 & n.25 (internal quotations omitted). More importantly, it was merely coincidental that no customer was harmed by these unsupervised variable annuity transactions.

3. Fillet Fails to Demonstrate Mitigating Factors

Fillet makes a variety of other unpersuasive arguments that there were mitigating factors. Fillet's mitigation arguments, however, have no merit and amount to nothing more than a request for credit for a lack of additional aggravating factors. *See Michael Frederick Siegel*, Exchange

Act Release No. 58737, 2008 SEC LEXIS 2459, at *43 (Oct. 6, 2008), *aff'd*, 592 F.3d 147 (D.C. Cir. 2010).

Fillet claims in favor of lesser sanctions that he cooperated with FINRA by traveling "to Philadelphia to FINRA's office voluntarily and without representation of counsel."[28] (Br. at 5.) Fillet misconstrues FINRA's Guidelines. The Guidelines provide that an associated person's substantial assistance to FINRA during an investigation is generally mitigating. *Guidelines*, at 7 (Principal Consideration No. 12). The record illustrates, however, that Fillet did not provide substantial assistance to FINRA, but rather cooperated as he was obligated to do.[29] Moreover, although FINRA provisions "permit the participation of counsel[,]" there is "no constitutional or statutory right to counsel in [FINRA] disciplinary proceedings."[30] *Falcon Trading Group, Ltd.*, 52 S.E.C. 554, 559 (1995), *aff'd*, 102 F.3d 579 (D.C. Cir. 1996). The fact that Fillet chose to proceed without counsel does not excuse that Fillet elected to lie by denying again and again the

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[28] Presumably, Fillet is referring to the on-the-record interviews that he had with FINRA staff in February 2009 and 2010 in Philadelphia. (RP 1107, 1127.)

[29] Fillet moreover misunderstands his obligations pursuant to Rule 8210 when he was a FINRA member. Upon joining FINRA, a member organization and its associated persons agree to comply with FINRA rules. *See* Article IV, § 1 of FINRA By-Laws. As a FINRA member, Fillet was therefore bound to comply with FINRA rules, including Rule 8210. *See UBS Fin. Servs. v. W. Va. Univ. Hosps., Inc.*, 660 F.3d 643, 649 (2d Cir. 2011); *Berger*, 2008 SEC LEXIS 3141, at *10 (2008). Fillet's obligation to provide Enforcement with on-the-record testimony was unequivocal. *See Berger*, 2008 SEC LEXIS 3141, at *13.

[30] To the extent that Fillet is arguing that he was somehow deprived due process, this argument too is without merit for several reasons. (Br. at 3, 5.) First, because FINRA is not a governmental actor, constitutional and common law due process requirements do not apply. *See Robert M. Ryerson*, Exchange Act Release No. 57839, 2008 SEC LEXIS 1153, at *11 (May 20, 2008). Second, the record shows that Fillet received a fair process in accordance with FINRA's Code of Procedure and the Exchange Act. *See* 15 U.S.C. § 78o-3(b)(8), (h)(1). Fillet was afforded a full opportunity to litigate and defend himself. Third, Fillet received fair notice as part of the appeals process that the NAC could modify the sanctions, including increasing the suspension for his fraud. *See* FINRA Rules 9348, 9349(a); (RP 1225-27, 1237-52). The record is clear that all the procedural safeguards required by the Exchange Act were satisfied.

backdating of documents during an on-the-record interview with FINRA staff. (RP 1111-1113, 1116-17, 1122-26.)

Fillet further argues that he has an "enviable" and "exemplary compliance record" with no prior disciplinary history. (Br. at 5.) That Fillet has not been previously disciplined is of no moment. *See Rooms*, 444 F.3d at 1214 (explaining that the lack of a disciplinary record is not a mitigating factor). Fillet should not be rewarded because he previously may have acted appropriately as a registered representative. *See Keyes*, 2006 SEC LEXIS 2631, at *23. Fillet's failure to accept responsibility for his actions and his continued blame of others directly supports the sanction imposed by the NAC. *Guidelines*, at 6 (Principal Consideration No. 2); *Patrick G. Keel*, 51 S.E.C. 282, 286-87 (1993).

As the NAC appropriately found, not only did Fillet falsify customer documents in order to mask his failure to supervise, he endeavored to camouflage his backdating scheme further by lying to FINRA. In furtherance of reduced sanctions and in an effort to excuse his lying, Fillet blames FINRA for not telling him the subject of its investigation or informing him how to prepare for his on-the-record testimony. (Br. at 5.) Fillet's excuses have been consistently rejected by the Commission: FINRA has no requirement to explain its reasons for making the information request or justify its relevance. *See Berger*, 2008 SEC LEXIS 3141, at *2 n.2.

When Fillet's actions are viewed comprehensively, a clear picture of deception emerges. Fillet's backdating of customers' variable annuity documentation and provision of these falsified Firm records to FINRA warrants the two-year suspension and $10,000 fine, and the Commission should affirm these sanctions.[31]

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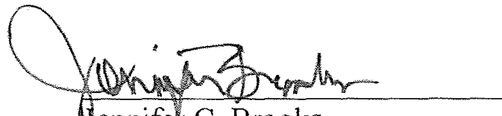
[31] The NAC modified the Hearing Panel's imposition of concurrent suspensions and ordered that Fillet serve his suspensions consecutively. (RP 1466.) The federal courts and the

[Footnote continued on next page]

V. CONCLUSION

Fillet placed his own self-interest ahead of the interests of investors in marketing a private placement of securities. In contravention of the antifraud provisions and NASD rules, Fillet ignored his unequivocal duty as a securities professional to represent accurately material information about CAC and FAO Sweet Shoppes. Fillet also falsified Firm documents and misrepresented their authenticity when confronted during a FINRA examination with his failure to supervise the Firm's variable annuity transactions. Taking into account the facts and circumstances of this case, the sanctions are entirely appropriate for Fillet's dereliction of his most basic obligations as a securities professional. The Commission should affirm the NAC's decision in all respects.

Respectfully submitted,



Jennifer C. Brooks
Associate General Counsel
FINRA
1735 K Street, NW
Washington, DC 20006
(202) 728-8083

February 28, 2014

[cont'd]

Commission have upheld the NAC's order of consecutive suspensions where the suspensions protect the public from two fundamentally different types of harms like the distinct harms in this case—fraudulently inducing an investment in securities and falsifying firm records and providing these to FINRA during the course of an examination. *See Siegel*, 592 F.3d at 157-58 (affirming consecutive suspensions imposed in *Siegel*, 2008 SEC LEXIS 2459, at *44-48).

Exhibit 1

THE RIDERWOOD GROUP INCORPORATED

CRD# 16681

SEC# 8-34325

Main Office Location

1107 KENILWORTH DRIVE
SUITE 206
TOWSON, MD 21204

Mailing Address

1107 KENILWORTH DRIVE
SUITE 206
TOWSON, MD 21204

Business Telephone Number

410-825-5445

Report Summary for this Firm

This report summary provides an overview of the brokerage firm. Additional information for this firm can be found in the detailed report.

Firm Profile

This firm is classified as a corporation.

This firm was formed in Maryland on 05/13/1985.

Its fiscal year ends in December.

Firm History

Information relating to the brokerage firm's history such as other business names and successions (e.g., mergers, acquisitions) can be found in the detailed report.

Firm Operations

This brokerage firm is no longer registered with FINRA.

Disclosure Events

Brokerage firms are required to disclose certain criminal matters, regulatory actions, civil judicial proceedings and financial matters in which the firm or one of its control affiliates has been involved.

Are there events disclosed about this firm? **Yes**

The following types of disclosures have been reported:

Type	Count
Regulatory Event	2
Arbitration	1

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Registration Withdrawal Information

This section provides information relating to the date the brokerage firm ceased doing business and the firm's financial obligations to customers or other brokerage firms.

This firm terminated or withdrew registration on:	01/28/2009
Does this brokerage firm owe any money or securities to any customer or brokerage firm?	No

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Firm Profile

This firm is classified as a corporation.

This firm was formed in Maryland on 05/13/1985.

Its fiscal year ends in December.

Firm Names and Locations

This section provides the brokerage firm's full legal name, "Doing Business As" name, business and mailing addresses, telephone number, and any alternate name by which the firm conducts business and where such name is used.

THE RIDERWOOD GROUP INCORPORATED

Doing business as THE RIDERWOOD GROUP INCORPORATED

CRD# 16681

SEC# 8-34325

Main Office Location

1107 KENILWORTH DRIVE
SUITE 206
TOWSON, MD 21204

Mailing Address

1107 KENILWORTH DRIVE
SUITE 206
TOWSON, MD 21204

Business Telephone Number

410-825-5445

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Firm Profile

This section provides information relating to all direct owners and executive officers of the brokerage firm.

Direct Owners and Executive Officers

Legal Name & CRD# (if any):	FILLET, MITCHELL HARRIS 207546
Is this a domestic or foreign entity or an individual?	Individual
Position	PRESIDENT, CEO, CCO, SHAREHOLDER
Position Start Date	01/2005
Percentage of Ownership	25% but less than 50%
Does this owner direct the management or policies of the firm?	Yes
Is this a public reporting company?	No

Legal Name & CRD# (if any):	FRENKIL, CAROLYN MCGUIRE MRS 4825647
Is this a domestic or foreign entity or an individual?	Individual
Position	STOCKHOLDER
Position Start Date	07/2004
Percentage of Ownership	25% but less than 50%
Does this owner direct the management or policies of the firm?	No
Is this a public reporting company?	No

Legal Name & CRD# (if any):	SHEIN, DONALD JEFFREY 4309570
Is this a domestic or foreign entity or an individual?	Individual
Position	STOCKHOLDER

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