BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C.

In the Matter of the Application of

Thaddeus J. North

For Review of

FINRA Disciplinary Action

File No. 3-17909

BRIEF OF THE FINANCIAL INDUSTRY REGULATORY AUTHORITY IN OPPOSITION TO APPLICATION FOR REVIEW

Alan Lawhead
Vice President and Director –
Appellate Group

Jante Turner
Associate General Counsel

Megan Rauch
Assistant General Counsel

FINRA
1735 K Street, N.W.
Washington, D.C. 20006
(202) 728-8863

July 14, 2017

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Federal Decisions **Pages**

SEC Decisions and Releases

FINRA Decisions

Federal Statutes and Codes

Commission Rules

FINRA Rules, Notices, Guidelines and Releases

MSRB Rules

BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C.

In the Matter of the Application of

Thaddeus J. North

For Review of

FINRA Disciplinary Action

File No. 3-17909

BRIEF OF THE FINANCIAL INDUSTRY REGULATORY AUTHORITY IN OPPOSITION TO APPLICATION FOR REVIEW

I. INTRODUCTION

Thaddeus J. North served as the chief compliance officer ("CCO") of Southridge Investment Group LLC ("Southridge"). Under Southridge's written supervisory procedures, North was responsible for: (1) ensuring that the firm complied with FINRA's reporting requirements under NASD Rule 3070; (2) establishing, maintaining, and enforcing the firm's written supervisory procedures relating to the review of electronic communications at the firm; and (3) reviewing electronic communications at the firm. North failed to discharge these responsibilities adequately and violated FINRA and MSRB rules.

The record amply supports the liability findings of the National Adjudicatory Council ("NAC"). Indeed, the NAC's findings are based almost entirely on undisputed facts and incontrovertible documentary evidence. First, it is undisputed that North never reported the business relationship of one of Southridge's associated persons with a statutorily disqualified individual. Second, the deficiencies in Southridge's written supervisory procedures, for which

North was responsible, are undisputed and self-evident. Third, North admits that he did not review any Bloomberg messages or Bloomberg chats—two of the three forms of electronic communications at Southridge for which he was responsible for reviewing—during the entirety of the relevant period. The NAC also relied, in part, on electronic reports generated by Smarsh, Inc. (the "Smarsh Reports") to support its finding that North failed to adequately review electronic correspondence during the relevant period. The Smarsh Reports, which reflect the frequency and scope of North's review of Southridge emails, were properly admitted into the record and are reliable. Further, the Smarsh Reports show that North's review of email—the third form of electronic communications at Southridge—was woefully inadequate. The NAC's findings of liability are sound.

Rather than address the NAC's findings, and the law and evidence supporting them, North continues on appeal to argue that FINRA conspired with Smarsh to "spoliate" the content of Southridge's electronic communications. North not only raised these arguments throughout the pendency of this disciplinary matter, but also in another FINRA matter and in actions he initiated in the United States District Court for the District of Columbia and the United States Court of Appeals for the District of Columbia.[1] These spurious claims should be rejected, as they were by the Hearing Panel, NAC, and federal court. The NAC explicitly rejected North's email spoliation arguments because the FINRA Department of Enforcement ("Enforcement") did not rely on email to prove the allegations against North. Moreover, the NAC properly concluded that North did not present persuasive evidence that the Smarsh Reports were unreliable or cogent arguments on appeal to disturb the Hearing Panel's credibility findings or procedural rulings

[1] In his opening brief, North also asserts that he filed a whistleblower complaint with the Commission concerning FINRA and Smarsh. Applicant's Br. at 15.

concerning North's proffered experts. Simply put, North's arguments are not supported by the record and are not based in reality.

The record also amply supports the NAC's sanctions for North's misconduct. The NAC weighed all relevant factors and imposed remedial sanctions which are neither excessive nor oppressive. These sanctions are consistent with FINRA's Sanction Guidelines (the "Guidelines") and fully warranted by the facts and circumstances of this case. The NAC's sanctions are reflective of the circumstances surrounding North's misconduct. The Commission should reject North's arguments to the contrary and dismiss North's application for review.

II. FACTUAL BACKGROUND

A. North's Background

North has worked in the industry since 1999. R. at 3430.[2] From February 2008 to August 2011, North was associated with Southridge and served as the firm's CCO. R. at 3429, 3473, 3570; Tr. at 293-94. He was registered as a general securities principal, registered options principal, general securities sales supervisor, general securities representative, equity trader limited representative, and investment banking limited representative. R. at 3429. During the relevant period, July 2009 to August 2011, Southridge had approximately 50 registered representatives in at least three branch offices. Tr. at 297, 352-53. North was responsible for reviewing all of Southridge's electronic communications at each of the firm's branch offices. R. at 3473-74, 3456, 3558, 3570; Tr. at 296.

---

[2] "R. at __" refers to the record page numbers in the certified record of this case. "Tr. at __" refers to transcript pages of the hearing conducted before the FINRA Hearing Panel on April 13-14, 2015. R. at 2635-3134. "Decision at __" refers to the NAC's March 15, 2017 decision.

B. Leslie King Enters into a Business Relationship with a Statutorily Disqualified Individual, Todd Cowle

Leslie King was associated with Southridge during the relevant period and registered as a general securities representative, general securities principal, and municipal securities principal. R. at 131-32. King primarily effected inter-dealer and customer trades in municipal bonds and government securities. R. at 24; Tr. at 205. King was one of two registered persons in Southridge's Plano, Texas branch office. Tr. at 196-97.

Prior to working at Southridge, King was associated with Southwest Texas Capital, LLC, where she worked with Thomas Cowle, a registered general securities representative. R. at 3444; Tr. at 196-97. In November 2007, FINRA found that Cowle willfully failed to disclose federal tax liens on his Uniform Application for Securities Industry Registration or Transfer ("Form U4"). R. at 3455-57, 3525-3533. Consequently, Cowle was sanctioned and subject to statutorily disqualification. R. at 3457, 3533; *see also* Exchange Act Section 15(b)(4)(A); FINRA By-Laws, Article III, Section 4(f). Southwest Texas Capital, LLC terminated Cowle in June 2009, and he has not since been registered with a FINRA member firm. R. at 3444.

Sometime prior to July 2009, William Schloth, Southridge's chief executive officer, considered hiring both King and Cowle as a registered representatives. R. at 173; Tr. at 386-87, 389. At Schloth's request, North ran a report on Cowle in the Central Registration Depository ("CRD"®), which reflected that Cowle was statutorily disqualified. Tr. at 386-87. Schloth decided not to hire Cowle because the firm would need to sponsor him through the FINRA continuing membership process before he could associate with a member firm. Tr. 386-87. Schloth nonetheless decided to hire King. R. at 131-32; Tr. 387.

On July 8, 2009, King completed new hire paperwork and associated with Southridge the next day. That same month, King formed King Asset Management ("KAM"), which she

disclosed as an outside business activity to Southridge. Tr. at 370. On July 15, 2009, King, on behalf of KAM, entered into a service agreement with Ultimate Tier Advisors, LLC ("UTA"), a company owned by Cowle. R. at 3481. Under the agreement, in exchange for payment as an independent contractor by KAM, UTA would deliver the following services: introduce KAM to street brokers in the securities industry and provide consultation, instruction, and training to King. R. at 3481. The agreement recognized that the services were not limited to those described, and that KAM and UTA were able to discuss additional business opportunities and compensation. R. at 3481. According to the agreement, UTA would remit invoices to KAM for services that UTA provided. R. at 3481. King signed the agreement on behalf of KAM, but no one signed on behalf of UTA. R. at 3481. Between July 2009 and September 2011, Cowle issued UTA invoices to KAM, and KAM paid at least 42 invoices totaling $605,365 for various services. R. at 3483-3524.

C. FINRA's Examinations of Southridge

In March 2010, FINRA staff conducted a routine examination of Southridge. Tr. at 217-18, 314-17. During the course of the examination, FINRA staff requested financial information about Southridge's Plano, Texas branch office. Tr. 362. North obtained from King invoices that UTA had issued to KAM. R. at 3483-3524; Tr. 217, 314, 320, 362, 380. North briefly looked over the invoices and then gave them to Schloth, who also was King's supervisor and the Plano branch manager. Tr. 314-15. Schloth then produced the invoices to FINRA. Tr. 315-16, 318-19. After receiving the invoices, FINRA requested any agreements relating to them. Tr. 321. North then saw the KAM-UTA service agreement for the first time, and either he or Schloth produced it to FINRA. Tr. at 320-22. The invoices and service agreement referenced UTA only, not Cowle. R. at 3483-3524. Despite not knowing anything about UTA, or the basis of the large invoices between KAM and UTA, North never asked King any questions about UTA, the service

agreement, or the invoices or conducted any investigation of KAM's business relationship with UTA. Tr. 318-322.

In December 2010, FINRA staff began an investigation of Southridge based on a regulatory tip that Cowle was being paid commissions for client referrals and other activities by King and another person. Tr. at 196-97. FINRA, pursuant to FINRA Rule 8210, requested additional information concerning King and Cowle's relationship. Tr. 330-34. Southridge produced additional UTA invoices received after the March 2010 in response to the FINRA Rule 8210 request. R. at 3465-66, 3483-3524. North asserts that he first learned that Cowle was connected to UTA in December 2010, yet he never reported to FINRA King's relationship with Cowle pursuant to NASD Rule 3070 in accordance with Southridge's written supervisory procedures. R. at 3568, 3570; Tr. at 325-26, 331-32.

D. Electronic Communications at Southridge

North was responsible for reviewing all electronic communications at Southridge. R. at 3473-74, 3546, 3558, 3570; Tr. 296. Southridge's electronic communications consisted of firm emails, Bloomberg messages, and Bloomberg chats during the relevant period. Tr. 220-21. Southridge relied on a vendor, Smarsh, Inc. ("Smarsh"), to archive its communications and provide Southridge with the ability to review the communications. R. at 3545, 3558; Tr. at 65, 69-71, 78, 83. Both Southridge's 2008 written supervisory procedures, effective until November 21, 2010, and its 2010 written supervisory procedures, effective thereafter, provided that Southridge utilized Smarsh for the archival and review platform of its electronic communications. R. at 3545, 3558. Southridge had access to the Smarsh Management Console ("SMC") to review the firm's emails and Bloomberg communications. Tr. at 69, 72-73, 79. North was the only person at Southridge who utilized the Smarsh SMC during the relevant period. Tr. at 83-85. Smarsh archived Southridge's email, Bloomberg messages, and

Bloomberg chats in three separate repositories. Tr. at 79-80. In order to review Bloomberg communications, North was required to conduct separate searches in the Smarsh SMC because emails and Bloomberg messages and chats were stored in separate repositories. Tr. at 79-80. North admits that he never reviewed any Bloomberg communications during the relevant period. Tr. at 342.

Smarsh's system recorded searches run by users, including their search history; message review history; the identity of the user who logged onto the system; the length of time of the search; the number of messages located through the search; and the number of messages actually reviewed by the user. Tr. at 73-74. All of this information was recorded in Smarsh's computer database automatically in "real time." Tr. at 76-77, 81. North relied upon the Smarsh system to record his review of electronic communications. Tr. at 304-05, 375. He did not create a separate record of his reviews. Tr. at 304-05, 375.

As part of its investigation, Enforcement requested that Smarsh create reports that reflected North's review of the firm's electronic communications during the relevant period—i.e., the Smarsh Reports. Tr. 85-86, 167-69. The Smarsh Reports in the record show: (1) the date of North's email searches; (2) the random percentage that he used to search emails; (3) the number of results obtained by the searches; (4) the number of emails archived for review; and (5) the maximum number of emails he reviewed. R. at 3583-3609.

III. PROCEDURAL HISTORY

On July 15, 2013, FINRA Enforcement filed a five-cause complaint against North, King, and Schloth. R. at 1-34. Only the third, fourth, and fifth causes of action were alleged against North.[3] R. at 27-30. Schloth settled within two months, so the case proceeded against only North and King.[4] R. at 150-60. North initially represented himself, but subsequently hired King's counsel. R. 173-79, 671. This same attorney represented North throughout the FINRA proceeding and continues to represent him on appeal before the Commission.

A. North and King's Motion for Summary Disposition with Claims of Evidence Spoliation and Proffer of Experts

On August 11, 2014, North and King, through counsel, filed a motion for summary disposition, claiming that there had been "intentional spoliation in bad faith of large quantities of relevant evidence." R. at 835, 3959. They proffered two experts, Andy Thomas and Dustin Sachs, who asserted that King's emails had been altered. R. at 4015-43, 985-1010. While the motion for summary disposition was pending, King hired new counsel, who filed a motion

---

[3] In cause three, Enforcement alleged that North failed to report King's relationship with a statutorily disqualified person, in violation of NASD Rule 3070(a)(9) and FINRA Rules 4530(a)(1)(H) and 2010. In cause four, Enforcement alleged that North failed to establish and maintain a supervisory system that was reasonably designed to achieve compliance with applicable securities laws related to the review of electronic correspondence, in violation of NASD Rule 3010(a) and (d) and FINRA Rule 2010, and in willful violation of MSRB Rules G-27(b) and (e) and G-17. In cause five, Enforcement alleged that North failed to adequately review electronic correspondence, in violation of NASD Rule 3010(b) and FINRA Rule 2010, and in willful violation of MSRB Rules G-27(a) and (c) and G-17. R. at 27-30.

[4] The sole charge against King was that she aided and abetted violations of the registration requirements of Section 15 of the Exchange Act through her business relationship with a statutorily disqualified individual (i.e., Cowle). R. at 24-25.

seeking to withdraw the motion for summary disposition as to King.[5] R. at 1973-74, 1991-92. While King's motion to withdraw was pending, the Hearing Officer denied the respondents' motion for summary disposition, finding that the respondents failed to demonstrate that there were no genuine issues of material fact. R. at 2019-25. Specifically, the Hearing Officer identified open issues as to the integrity of Southridge's electronic communications that Enforcement had obtained from Smarsh and produced to North and King.[6] R. at 2019-25.

B. North's Motions to Present Expert Testimony Regarding Evidence Spoliation

On February 6, 2015, North filed a motion, and a later supplement, to present the expert testimony of two different experts—Jon Berryhill and either Thomas McCay or Jonathan Gibney. R. at 2079-2112, 2149-58. North described them as "persons with expertise in electronic file transportation and preservation" and proffered that they "will offer factual and opinion testimony relevant to a determination about the nature and extent of spoliation of the electronically stored information ('ESI') relevant to the complaint and defenses in this matter."

---

[5] In her motion, King stated she "no longer wish[ed] to pursue the claims of spoliation advanced by [her previous counsel] on [her] behalf." R. at 1991.

[6] Thereafter, North petitioned the United States Court of Appeals for the District of Columbia Circuit for an emergency petition for writ of mandamus, temporary and permanent injunctive relief, and stay of proceedings before FINRA. The court denied the petition. *In re North*, No. 14-1274, 2014 U.S. App. LEXIS 23348 (D.C. Cir. Dec. 11, 2014). North subsequently filed an action in the United States District Court for the District of Columbia against FINRA and Smarsh alleging that the data produced by Smarsh and relied upon by FINRA in this proceeding and another against North was spoliated and tampered. North sought monetary damages for the intentional or negligent spoliation of data and to enjoin FINRA's disciplinary actions against him as well as to prevent the dissemination and use of such data in any future proceeding. The district court dismissed the action on December 4, 2015. *North v. Smarsh, Inc.*, 160 F. Supp. 3d 63 (D.D.C. 2015). In dismissing the action, the court identified that allegations against North in this proceeding—"whether Mr. North reviewed sufficient electronic correspondence as required by the securities laws and regulations—have nothing to do with the content of the spoliated ESI [electronically stored information]." *Id.* at *86.

R. at 2079. In its opposition, Enforcement asserted that the spoliation claims were spurious but, more importantly, not relevant to the allegations against North because Enforcement's intended proof of North's violations did not include electronic correspondence.[7] R. at 2235-2245. Rather, Enforcement intended to rely on testimony, Southridge's written supervisory procedures, and the Smarsh Reports. R. at 2237.

The Hearing Officer denied North's motion. R. at 2253-54. The Hearing Officer found that "North failed to demonstrate that the expert testimony would be relevant or helpful to the Hearing Panel in resolving the issues in controversy relating to North." R. at 2253. The Hearing Officer further explained that North failed to explain how the proposed expert testimony "relate[d] to [the] charges or a valid defense" or how the expert testimony was "relevant to . . . the evidence against North."[8] R. at 2374.

C. Evidentiary Hearing Regarding the Admissibility of the Smarsh Reports

King settled the charges against her on March 17, 2015, so the hearing proceeded solely against North. R. at 2383-93. On April 13, 2015, the morning of the hearing, the Hearing Panel held an evidentiary hearing regarding the admissibility of the Smarsh Reports offered by Enforcement. Tr. at 1-156. Robert Sherman, a Smarsh senior manager of client data and manager of a team that handles data that is imported into and exported from Smarsh, testified

---

[7] Enforcement's intended proof against King did rely on electronic correspondence and emails, but she had withdrawn her support of the spoliation claims and consented on December 9, 2014, to an order granting preclusion that she could not make such claims at the hearing. R. at 2029.

[8] The Hearing Officer subsequently denied North's motion for reconsideration. R. at 2519-20. He emphasized that the proposed expert testimony was irrelevant to the Smarsh Reports and observed that the proposed testimony did not explain "why any of the Smarsh Reports are unreliable because of alleged spoliation of electronic communications." R. at 2520.

telephonically about the reports. Tr. at 1-156. He was cross-examined by North's counsel and was questioned by the panelists. Tr. at 119-56. After hearing Sherman's testimony, the Hearing Officer admitted the Smarsh Reports over North's objections. Tr. at 156-174.

D. The Hearing Panel's Decision

The Hearing Panel issued its decision on December 1, 2015. R. at 3355-3379. The Hearing Panel found that North engaged in the misconduct as alleged in the complaint.[9] R. at 3355, 3378-79. For failing to report a relationship with a statutorily disqualified person, the Hearing Panel fined North $10,000 suspended him from association with any FINRA member firm in all principal capacities for 30 business days. R. at 3376. For failing to establish a reasonable supervisory system for the review of electronic correspondence, the Hearing Panel fined North $10,000 and censured him. R. at 3376-77. For failing to supervise electronic communications, the Hearing Panel fined North $20,000 and suspended him in all principal capacities for two months. R. at 3377-78.

E. The NAC's Decision

North appealed the Hearing Panel's decision to the NAC. R. at 3381-3403. While on appeal to the NAC, North filed a motion under FINRA Rule 9346 to adduce additional evidence to support the same spoliation claims. R. 3755-3930. His proposed evidence included the report of yet another expert, Frank Huber. R. at 3757-58. The NAC subcommittee empaneled to consider North's appeal denied North's motion to adduce. R. at 5065.

---

[9] With respect to the third cause of action, the Hearing Panel found that North failed to report King's relationship with a statutorily disqualified person, in violation of NASD Rule 3070(a)(9) and FINRA Rule 2010, but dismissed the allegation that his misconduct also violated FINRA Rule 4530(a)(1)(H). R. at 3364, 3379.

In its decision dated March 15, 2017, the NAC modified the Hearing Panel's liability findings and sanctions. Decision at 1-24. The NAC found that North failed to report King's relationship with a statutorily disqualified person, in violation of NASD Rule 3070(a)(9) and FINRA Rule 2010. Decision at 7. The NAC also found that North failed to establish a reasonable supervisory system for the review of electronic correspondence and failed to adequately review electronic correspondence, in violation of NASD Rule 3010 and FINRA Rule 2010 and in willful violation of MSRB Rule G-27.[10] Decision at 9-10, 12. In making these determinations, the NAC explicitly rejected North's arguments related to electronic correspondence, including without limitation North's arguments about evidence spoliation, the admissibility of the Smarsh Reports, and the exclusion of North's proposed experts. Decision at 13-17.

The NAC also modified the Hearing Panel's sanctions. First, the NAC reversed the censure imposed by the Hearing Panel. Decision at 22. Second, the NAC modified the suspensions imposed by the Hearing Panel to be in all principal and supervisory capacities. Decision at 20, 23. In assessing sanctions, the NAC found that North's failure to adequately review electronic communications was egregious and reckless, and thus warranted significant sanctions. Decision at 23. The NAC noted that the firm's written supervisory procedures were insufficient, but that North compounded the problem with his inadequate review of electronic communications. Decision at 23. The NAC also found that North's failure to report King's relationship with a statutorily disqualified individual was at least negligent. Decision at 20. In

[10] The NAC reversed the Hearing Panel's finding that North's conduct also violated MSRB Rule G-17. Decision at 10, 12 n.18.

its decision, the NAC also affirmed the NAC subcommittee's denial of North's motion to adduce because the proposed evidence was immaterial.[11] Decision at 17 n.27.

North appealed the NAC's decision to the Commission and moved to stay the sanctions that FINRA imposed. On April 19, 2017, the Commission denied North's motion to stay as moot.

IV. ARGUMENT

The record fully supports the NAC's findings for the three causes of action at issue. First, the record demonstrates that North violated NASD Rule 3070(a)(9) and FINRA Rule 2010 by failing to report an associated person's relationship with a statutorily disqualified individual. It is undisputed that King, an associated person at Southridge, entered into a business activity with Cowle, a statutorily disqualified individual. R. at 3457, 3481, 3533. It also is undisputed that North failed to report to FINRA King's business activity with Cowle. Tr. at 325-26. North should have learned about King's relationship with Cowle shortly after March 2010, when he saw the KAM-UTA service agreement and invoices that Southridge produced to FINRA. R. at 3483-91; Tr. at 314-15, 318-22.

Second, the record supports the NAC's findings that North violated NASD Rule 3010 and FINRA Rule 2010 and willfully violated MSRB Rule G-27 by failing to establish a reasonable supervisory system for the review of electronic correspondence. North does not dispute that he was responsible for establishing and maintaining Southridge's written supervisory

---

[11] Contrary to North's assertions on appeal, the NAC did not "rubber stamp" the decision of the Hearing Panel. Applicant's Br. at 26. The NAC thoughtfully considered the entire record, as evidenced by its 24-page decision which modified the Hearing Panel's liability findings and sanctions. The NAC also did not "disproportionately enhance" the Hearing Panel's sanction. Applicant's Br. at 26. Rather, the NAC reversed the censure imposed by the Hearing Panel and clarified that the suspensions were to be in all principal and supervisory capacities. Decision at 19-24.

procedures. R. at 3473-74, 3546, 3558, 3570; Tr. 296. It is self-evident that both the 2008 and 2010 procedures were incomplete, inadequate, and unreasonable under FINRA and MSRB Rules. R. at 3545-46, 3554-56.

Third, the record supports the NAC's findings that North violated NASD Rule 3010 and FINRA Rule 2010 by failing to adequately review electronic communications during the relevant period. North admits he was the responsible principal for reviewing electronic correspondence at Southridge. Tr. 296. North also admits that he never reviewed any Bloomberg communications at Southridge during the relevant period, which in and of itself is sufficient to find him liable under the relevant rules. Tr. at 342. The record further establishes that North's sporadic and haphazard review of emails during the relevant period also was inadequate. R. at 3583-3609.

On appeal before the Commission, North yet again attempts to conjure support for his spurious claims that FINRA and Smarsh conspired together to intentionally corrupt the evidence to be used against him. North's arguments are without merit and have been rejected in a variety of forums. There is no conspiracy.[12] There is, however, substantial evidence that North failed to report an associated person's relationship with a statutorily disqualified individual, failed to establish and maintain reasonable written supervisory procedures regarding the review of electronic communications, and failed to adequately review electronic communications during

---

[12] In his opening brief, North cites a variety of documents not in the record, including briefs and exhibits he filed in federal court actions in which he made similar conspiracy and spoliation allegations against Smarsh and FINRA. North is attempting, improperly, to use the arguments he put forth in these documents as evidence or fact in this matter before the Commission. Further, North is citing to documents not in the record in contravention of the Rules of Practice before the Commission. *See* SEC Rule of Practice 450(b), 17 C.F.R. § 201.450(b) (detailing that briefs before the Commission "shall be supported by citation to the relevant *portions of the record*") (emphasis added). The Commission should disregard these efforts.

the relevant period. To be clear, whether Southridge emails were spoliated has no bearing whatsoever on the allegations, or the findings, against North. Indeed, the NAC considered these same arguments and rejected them based on the record, overwhelming evidence, and established case law. The Commission should affirm FINRA's liability findings.

The Commission also should affirm the sanctions imposed by the NAC. The cumulative sanctions—$40,000 fine, 30-business-day suspension in all principal and supervisory capacities followed by a two-month suspension in all principal and supervisory capacities with any FINRA member firm—are neither excessive nor oppressive. The NAC's sanctions are appropriately remedial, consistent with the Guidelines, and fully warranted by the facts and circumstances of North's misconduct.

A. North Failed to Report an Associated Person's Relationship with a Statutorily Disqualified Individual

The record shows that North failed to report to FINRA King's relationship with a statutorily disqualified individual, in violation of NASD Conduct Rule 3070(a)(9) and FINRA Rule 2010. The Commission should affirm the NAC's findings.[13]

North was responsible for Southridge's compliance with NASD Rule 3070 reporting requirements in both the 2008 and 2010 written supervisory procedures.[14] R. at 3543-443568. And it is undisputed that North never filed with or electronically reported to FINRA King's

---

[13] Throughout his opening brief, North references the findings of the FINRA Hearing Panel. It is the opinion of the NAC, not the Hearing Panel, that is the final FINRA action subject to Commission review. *See David Evansen*, Exchange Act Release No. 75531, 2015 SEC LEXIS 3080, at *51 (July 27, 2015). Therefore, FINRA's opposition brief focuses on those arguments that refer to the NAC's findings.

[14] In the 2008 procedures, the compliance officer was required to file the disclosure event with FINRA. R. at 3544. The 2010 procedures, which specifically identified North as CCO, provided that the CCO was responsible for filing events under NASD Rule 3070. R. at 3568, 3570.

business activity with Cowle, a person subject to statutory disqualification. R. at 3457, 3481, 3533; Tr. at 325-26.

NASD Rule 3070(a)(9), effective through June 30, 2011, is extremely broad. The rule required a member firm to report to FINRA whenever it, or one of its associated persons, was "associated in any business or financial activity with any person who is subject to a 'statutory disqualification' . . . and the member knows or should have known of the association." NASD Rule 3070(b) establishes the timeframe for reporting requirements and provides that "[e]ach member shall report to [FINRA] not later than 10 business days after the member knows or should have known of the existence of any of the conditions set forth in paragraph (a) of this rule." NASD Rule 3070 is made applicable to associated persons by FINRA Rule 0140. A violation of NASD Rule 3070 is a violation of FINRA Rule 2010. *See William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *26 (July 2, 2013), *aff'd sub nom.*, *Birkelbach v. SEC*, 751 F.3d 472 (7th Cir. 2014).

As of July 15, 2009, King was associated in a business activity with Cowle. R. at 3481. Under NASD Rule 3070, North was required to report that relationship 10 business days after he knew or should have known of the existence of the relationship. *See* NASD 3070(b). The NAC properly concluded that North should have learned about the relationship with Cowle shortly after March 2010, when he produced to FINRA the KAM-UTA service agreement and invoices. R. at 3483-91; Tr. at 314-15, 318-22. The monthly invoices submitted by UTA from July 2009 to February 2010 totaled $151,800 with little description about the services being provided, and the one-page service agreement was vague and was not executed by anyone on behalf of KAM. R. at 3483-91. In light of these red flags, North, Southridge's CCO and responsible principal for

NASD Rule 3070 reporting under the firm's written supervisory procedures, should have sought additional details about King's business dealings with UTA shortly after March 2010.

North argues that he was not responsible for investigating potential reportable events and he relied on the conclusions of Schloth and others. Applicant's Br. at 30-31. Specifically, North asserts, "[Schloth] took over the duty to investigate and his conclusions were the determination of the firm." Applicant's Br. at 30. North's argument misses the mark. North ignores that he shared responsibility with "Southridge's management," and he cannot abdicate his responsibilities as the CCO and designated principal under Southridge's written supervisory procedures to investigate and report NASD Rule 3070 reportable events. *See John Edward Mullins*, Exchange Act Release. No. 66373, 2012 SEC LEXIS 464, at *51 (Feb. 10, 2012) ("[I]t is well established that an associated person cannot excuse his own misconduct by shifting the onus of compliance to his managers or to his firm."). By his own admission, North conducted no independent investigation of KAM and UTA's business relationship at any time. Tr. 318-322. Nor did North prepare a memo to file to document any discussion with Schloth about King's relationship with Cowle or why it should not be considered a reportable event. Tr. 384.

North also argues that the NAC "presumed facts not in evidence" Applicant's Br. at 31. North is wrong. Whether Southridge or King "knowingly associated [Cowle], directly or indirectly controlled [Cowle], or were controlled by [Cowle]" is irrelevant to the NAC's findings. NASD Rule 3070 triggers the reporting requirement to FINRA when an associated person is associated in *any* business or financial activity with a statutorily disqualified individual. NASD Rule 3070. Thus, North was required to report King's relationship with Cowle regardless

of whether their relationship was in violation of other FINRA rules or Section 15 of the Securities Exchange Act of 1934 (the "Exchange Act").[15]

North further argues that the NAC presumed that North had "access to material but unidentified facts from unidentified sources and would have reached different conclusions than the firm's management." But it is precisely North's failure to even attempt to conduct an investigation despite red flags that forms the basis of the NAC's finding that North should have learned about the relationship, and reported it, shortly after March 2010. Decision at 6.North's argument also ignores that North admitted that he was aware of King's relationship with Cowle in December 2010, but nonetheless continued to fail to report the relationship to FINRA. Tr. 331-334.

In sum, the NAC properly found that North failed to report to FINRA King's relationship with Cowle, in violation of NASD Rule 3070(a)(9) and FINRA Rule 2010.

B. North Failed to Establish a Reasonable Supervisory System for the Review of Electronic Correspondence

The record establishes that North failed to establish a reasonable supervisory system for the review of electronic correspondence, in violation of NASD Rule 3010(a) and (d) and FINRA Rule 2010 and in willful violation of MSRB Rule G-27(b) and (e). The Commission should affirm the NAC's findings.

NASD Rule 3010(a) required FINRA members to "establish and maintain" a supervisory system that is reasonably designed to achieve compliance with applicable securities laws and FINRA rules. NASD Rule 3010(d) required member firms to establish written procedures "for

---

[15] Moreover, Schloth's alleged conclusion that the relationship was not reportable was simply unreasonable considering the broad definition under NASD Rule 3070(a)(9); if an associated person had *any* business or financial relationship with a statutorily disqualified person, it was reportable.

the review by a registered principal of incoming and outgoing written and electronic correspondence of its registered representatives with the public relating to the investment banking or securities business of such member." NASD Rule 3010(d)(1). The rule further required that a member firm develop written procedures that are "appropriate to [the member's] business, size, structure, and customers for the review of incoming and outgoing written (i.e., non-electronic) and electronic correspondence with the public relating to its investment banking or securities business." NASD Rule 3010(d)(2). MSRB Rule G-27 is substantially similar to NASD Rule 3010 in the relevant parts but is applicable to dealers of municipal securities. *Compare* MSRB Rules G-27(b), (e), *with* NASD Rule 3010(a), (d). A violation of NASD Rule 3010 also is a violation of FINRA Rule 2010. *See Wedbush Sec., Inc.*, Exchange Act Release No. 78568, 2016 SEC LEXIS 2794, at *35 n.36 (Aug. 12, 2016), *appeal docketed*, No. 16-73284 (9th Cir. Oct. 10, 2016).

Southridge's written supervisory procedures establish that North was responsible for establishing and maintaining Southridge's written supervisory procedures. R. at 3537-38, 3558, 3572. Both sets of procedures provided that Smarsh would provide electronic messaging archiving and a platform for reviewing the archived messages. R. at 3545, 3558. The 2008 written supervisory procedures, in effect until November 21, 2010, stated "[t]he CCO reviews a sample of daily electronic communications by either selecting 'random message' or sometimes by individual [registered representative] mailbox." R. at 3546; Tr. 293-94. The 2008 procedures did not specify a method and frequency of review, the size of the review sample, or how North would document the review. R. at 3545-46. The 2010 procedures provided that the firm would employ a "risk-based approach" and that the CCO will "[u]tilize SMARSH to review random samples of emails," "[u]tilize appropriate lexicon that can be amended, as necessary," and

"[m]aintain appropriate documentation of electronic communications review (SMARSH)." R. at 3558. The 2010 procedures were incomplete and provided that "[a]n appropriate random sampling (ENTER PERCENTAGE OR OTHER DEFINABLE SAMPLE SIZE) of all copies of e-mail will be reviewed." R. at 3554, 3556. The procedures also did not specify the frequency of reviews. R. at 3554-3558.

The NAC properly concluded that both sets of Southridge's written supervisory procedures relating to the review of electronic correspondence were unreasonable. Decision at 9. Both sets of procedures lacked specificity regarding the size of the review sample, method, frequency of the review, and documentation of the review. These omissions are contrary to FINRA guidance. *See FINRA Regulatory Notice 07-59*, 2007 FINRA LEXIS 58, at *32, 35 (Dec. 2007); *NASD Notice to Members 98-11*, 1998 NASD LEXIS 12, at *5 (Jan. 1998).

North argues that his supervisory failings were limited to "a single scrivener's error" and therefore "not sanctionable." Applicant's Br. at 27. North's argument is unpersuasive. *See, e.g., Dep't of Enforcement v. Legacy Trading Co.*, Complaint No. 2005000879302, 2010 FINRA Discip. LEXIS 20, at *36 (FINRA NAC Oct. 8, 2010) (imposing liability for firm's written procedures that were "incomplete, in draft form, and not tailored specifically to [its] business"). Moreover, North's argument addresses only North's failure to complete the boilerplate language in the 2010 procedures but ignores the NAC's well-supported findings that both the 2008 procedures and 2010 procedures lacked specificity regarding the size of the review sample, method, frequency of the review, and documentation of the review.

North was responsible for establishing and maintaining a reasonable supervisory system for the review of electronic correspondence at Southridge, and the NAC properly concluded the 2008 and 2010 written supervisory procedures were unreasonable under the circumstances. The

Commission therefore should affirm the NAC's finding that North violated NASD Rule 3010, FINRA Rule 2010, and MSRB Rule G-27.

C. North Failed to Adequately Review Electronic Correspondence

The record establishes that North's review of electronic correspondence at Southridge was inadequate, in violation of NASD Rule 3010(b) and FINRA Rule 2010 and in willful violation of MSRB Rule G-27(a) and (c). The Commission should affirm the NAC's findings.

NASD Rule 3010(b) requires members to "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons." NASD Rule 3010(b)(1). MSRB Rule G-27 is substantially similar to NASD Rule 3010 in the relevant parts. *Compare* NASD Rule 3010(b), *with* MSRB Rule G-27(a) and (c). A FINRA member must implement and enforce its supervisory system and written procedures reasonably in light of the circumstances presented. *See Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008).

North was responsible for the review of electronic communications at Southridge. R. at 3473-74, 3546, 3558, 3570; Tr. 296. The evidence supports that his review—which was infrequent, sporadic, and superficial—was unreasonable. First, North admits he did not review any Bloomberg communications during the relevant period.[16] Tr. at 342. This admission alone renders North liable under the applicable rules. Second, the Smarsh Reports show that North's email reviews also were inadequate. R. at 3583-3609. From July 1, 2009, through September 1, 2011, North conducted email reviews 36 times. In 13 of the 27 months comprising this period,

[16] North does not address in his opening brief his admission about his failure to review Bloomberg communications.

he reviewed no emails. There were also significant intervals—ranging from three to five months—in which he failed to review any emails. From June 2010 through August 2011, North reviewed emails only six times. North also admits that he never subjected King's electronic communications to an amplified review after March 2010, when he saw the KAM-UTA service agreement and invoices (or even after December 2010, when he learned about King's relationship with Cowle), which required under Southridge's written supervisory procedures risk-based approach. R. at 3558, 3583-3609. Like North's nonexistent review of Bloomberg communications, North's review of emails was unreasonable under the circumstances. *See Pellegrino*, 2008 SEC LEXIS 2843, at *33.

In sum, the NAC properly concluded that North failed to adequately review electronic correspondence at Southridge, in violation of NASD Rule 3010, FINRA Rule 2010, and MSRB Rule G-27.

D. North's Violations of MSRB Rule G-27 Were Willful

The NAC found that North's violations of MSRB Rule G-27 were willful. Decision at 9-10, 12. These findings also are fully supported by the record, and, as a result, North is statutorily disqualified.

A willful violation of the federal securities laws means simply "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). To find that North's actions were willful, the Commission must conclude only that North voluntarily engaged in the misconduct. *See id.* The Commission need not conclude that North intentionally violated MSRB rules or acted with a culpable state of mind. *See id.* (finding that the law does not require that the willful actor "also be aware that he is violating one of the Rules or Acts"); *see also Jason A. Craig*, Exchange Act Release No. 59137, 2008 SEC LEXIS 2844, at *13 (Dec. 22, 2008) (finding that

the law merely requires that the willful actor "voluntarily committed the acts that constituted the violation").

Under these criteria, North's failure to establish and maintain adequate written supervisory procedures with respect to electronic communications was voluntary and thus willful. North knew he was responsible for establishing and maintaining Southridge's written supervisory procedures, so he either knew or should have known that the procedures did not adequately address the review of electronic communications. Besides failing to address the deficiencies in the 2008 written supervisory procedures, North failed to complete the template for review of electronic correspondence in the 2010 procedures. His misconduct, even if unintentional, does not negate the NAC's willful finding. *See Wonsover*, 205 F.3d at 414.

North's failure to review any Bloomberg communications and his inadequate review of emails also was voluntary and thus willful. North admitted that he never reviewed any Bloomberg communications because he did not know that he needed to run separate searches in the Smarsh SMC. Tr. 112-113, 234, 299. But it was North's obligation, as Southridge's CCO and designated principal under Southridge's written supervisory procedures for the review of electronic communications, to understand how the firm's compliance system worked. At the very least, the fact that none of North's searches on the Smarsh SMC returned any Bloomberg communications should have alerted him that his review was inadequate. North also admitted that he never subjected King's electronic communications to heightened review after the presence of red flags, which is yet another example of a voluntary act. In sum, North should have known he was not adequately reviewing electronic communications at Southridge.

On appeal, North argues that his misconduct does not warrant the "enhanced penalty" of statutory disqualification. Applicant's Br. at 35. North's argument misses the mark. Statutory

disqualification is not a penalty or sanction. *See Michael Earl McCune*, Exchange Act Release No. 77375, 2016 SEC LEXIS 1026, at *37 (Mar. 15, 2016), *aff'd*, 672 F. App'x 865 (10th Cir. 2016). Rather, it is mandated by operation of Sections 3(a)(39) and 15(b)(4)(D) of the Exchange Act based on the NAC's finding that North willfully violated MSRB Rule G-27.

E. FINRA Provided a Fair Procedure

FINRA is required to provide a fair procedure for disciplining associated persons. This is achieved by filing specific charges, notifying a respondent of those charges, giving him a chance to defend himself, and keeping a record of the proceedings. *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at *48 (Nov. 9, 2012). FINRA satisfied each of these requirements. Rather than address any of the myriad deficiencies of his review of electronic correspondence, the inadequacy of the firm's written supervisory procedures, or his failure to report King's relationship with a statutorily disqualified individual, North spins conspiracy theories about evidence spoliation and attacks various procedural rulings by the Hearing Officer and the NAC. These arguments do not merit serious consideration and were explicitly rejected by the Hearing Panel and the NAC. The Commission should likewise dismiss these arguments in their entirety.

1. The Smarsh Reports Were Admissible and Reliable

North asserts that Smarsh did not have the ability to produce the Smarsh Reports and therefore the Smarsh Reports were "fake." Applicant's Br. at 16, 24. North's claims are patently false. The Hearing Officer did not abuse his discretion by admitting the Smarsh Reports, and the reliability of the Smarsh Reports is well supported by the record.

The admission of the Smarsh Reports is consistent with FINRA's Code of Procedure. *See* FINRA Rule 9263(a). Robert Sherman, the Smarsh senior manager of client data who oversaw the creation of the Smarsh Reports, testified telephonically at an evidentiary

hearing about the reports, was cross-examined by North's counsel, and was questioned by the panelists. Applying FINRA Rule 9263, the Hearing Officer admitted the Smarsh Reports.

On appeal, North has not sustained his heavy burden to show that the Hearing Officer abused his discretion by admitting the Smarsh Reports. *See Robert J. Prager*, 58 S.E.C. 634, 664 (2005). The Smarsh Reports, which show North's infrequent reviews of a small number of emails during the relevant period, are directly relevant to FINRA's allegation that North failed to adequately review electronic communications at Southridge.

Not only were the Smarsh Reports admissible, but the NAC properly concluded that the reports were reliable as well. Decision at 14-15. Based on the credibility findings about Sherman's and North's testimony, the NAC dismissed North's arguments that the Smarsh Reports were inaccurate because of an alleged failure to capture and archive email. Decision at 15. The NAC, like the Hearing Panel, found that the Smarsh Reports were reliable based on Sherman's "persuasive" testimony at the evidentiary hearing. Decision at 15. And the NAC, like the Hearing Panel, did not credit North's testimony regarding his review of emails, finding it "tentative, uncorroborated, and at times inconsistent." Decision at 15. It is well established that "[c]redibility determinations by a fact-finder deserve 'special weight.'" *Daniel D. Manoff*, 55 S.E.C. 1155, 1162 n.6 (2002); *see also William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *30 n.45 (Mar. 31, 2016) (explaining that credibility determinations "based on hearing the witness's testimony and observing demeanor . . . are entitled to considerable deference"), *appeal docketed sub nom.*, *Harris v. SEC*, No. 16-1739 (2d Cir. May 31, 2016).

Contrary to North's arguments on appeals, it was not necessary to have the underlying emails or other records to admit or rely on the Smarsh Reports. Applicant's Br. at 20. Indeed,

Sherman's testimony "validat[ed]" the content of the Smarsh Reports because Sherman unequivocally testified that the Smarsh Reports "[were] based off of the search and review history in the database," and the reports were not prepared using the information derived from emails.[17] Tr. at 77, 127-28.

North, relying on Federal Rule of Evidence 1006, also argues that the Smarsh Reports were summary exhibits that the Hearing Officer improperly admitted without the underlying supporting emails and without proper authentication. Applicant's Br. at 22. These arguments were considered and rejected by the NAC. Decision at 15. The formal rules of evidence do not apply in FINRA disciplinary proceedings. *See* FINRA Rule 9145(a). Moreover, the Smarsh Reports are not summary exhibits, but printouts of data, compiled automatically at the time of North's review and stored in Smarsh's database in the course of Smarsh's business. Tr. at 76-77. Sherman properly authenticated the Smarsh Reports at the evidentiary hearing and explained how they were created and what data was used. Tr. at 1-156.

Finally, North argues that allegedly spoliated emails are relevant to his claim that the Smarsh Reports are unreliable "if it contains proof that Smarsh did not have the capacity or intent to support the alleged SMC from which the alleged Smarsh Reports were derived." Applicant's Br. at 21. North's argument is a red herring. As addressed by the NAC, "North is not being found liable for Smarsh's alleged failure to archive electronic communications or his inability to turn up particular emails during his searches. Rather, North is being found liable for

---

[17] North seeks to undercut Sherman's credibility by pointing to his testimony that Smarsh did not migrate Bloomberg communications to its upgraded system. Applicant's Br. at 23; Tr. at 119-121. North conveniently forgets that FINRA did not use the Smarsh Reports to prove that North did not review Bloomberg communications. Indeed, North admitted that he never reviewed Bloomberg communications, and the Smarsh Reports were used to show North's infrequent and haphazard review of emails only.

his failure to adequately review electronic communications based on the Smarsh Reports, which convincingly show infrequent reviews of a small number of emails." Decision at 16. Contrary to North's assertions, Enforcement's choice to not rely on emails for its case against North was not "intended to avoid expert testimony [or] inquiry into accuracy of the content of the Smarsh Reports." Applicant's Br. at 22. Rather, Enforcement did not need to use Southridge's email to prove the allegations against North. And the NAC explained in great detail in its decision why it was irrelevant whether emails were in fact spoliated, which is well supported by the record. Decision at 12.

In sum, the Commission should reject North's unsubstantiated claims about the admissibility and reliability of the Smarsh Reports.

2. The Hearing Officer Properly Excluded North's Experts

North argues that the Hearing Officer abused his discretion by excluding North's proffered experts. There is no merit to this argument, and the Commission should reject it.

North's proffered expert testimony about the "extent and condition of the Email data, likely causes of the failure of the archive, the alteration, spoliation and tampering to the files, and responsible party(ies)." R. at 2079. This proposed testimony, however, did not address the reliability of the Smarsh Reports and its real-time populated "search and review history" database from which they were created. The Hearing Officer therefore properly concluded that North's proposed expert testimony was not relevant and excluded the testimony. R. at 2253-54, 2374.

On appeal, North still is unable to offer any cognizable argument that "spoliated" emails could affect the data in the Smarsh Reports about the frequency of North's email review or the extent of North's searches. Without support, North asserts that the "Hearing Officer's determination that [e]mail was irrelevant was designed to hide the fact that FINRA corrupted it."

Applicant's Br. at 19. This accusation falls flat. As explained by the NAC, Sherman credibly testified that the Smarsh Reports were derived from the "search and review history" database, so whether the emails were "spoliated" would not affect the reliability of the Smarsh Reports. R. at 127-28; Decision at 15.

3. The NAC Properly Denied North's Motion to Adduce Additional Evidence

North argues that the NAC subcommittee improperly denied his motion to adduce additional evidence because "it too was motivated to avoid confronting FINRA's and Smarsh's illegal conduct and kept the NAC Panel ignorant of the additional evidence." Applicant's Br. at 26. Contrary to North's assertions, the NAC subcommittee's denial of North's motion, which was affirmed by the NAC, is well supported by the record and FINRA rules.

Pursuant to FINRA Rule 9346, a motion for leave to introduce additional evidence must demonstrate that there was good cause for the respondent's failure to introduce the evidence in the proceedings before the Hearing Panel, and it must explain why the evidence is material. FINRA Rule 9346(b). North's proposed evidence fails on both counts. Each of the documents North sought to adduce related to his claims about spoliated emails, which claim both the Hearing Officer and the NAC found irrelevant to the allegations against North. Therefore, the NAC concluded that the documents were immaterial. Decision at 17 n.27. Moreover, the majority of proffered documents North sought to introduce were declarations by yet another expert, Frank Huber, but the information Huber examined was available to North well in advance of the hearing in this matter. North's offer of Huber's declarations was an attempt to circumvent the Hearing Officer's prior rulings related to expert testimony. North also sought to introduce documents related to a different FINRA disciplinary matter involving North's misconduct occurring at a different firm, which had no bearing on the allegations in this matter. The

documents filed in North's federal district court action are likewise immaterial. In sum, North failed to sustain his heavy burden to show that his proffered evidence was material and that he had good cause for failing to introduce it before the Hearing Panel.

4. FINRA's Adverse Rulings Were Correct and Do Not Reflect Bias Against North

North argues that both the Hearing Officer and the NAC Subcommittee were motivated by bias. The Commission should reject these meritless arguments.

North first claimed in his appeal before the NAC that the Hearing Officer was biased against him "due to his connection to prior proceedings involving [Cowle]."[18] Applicant's Br. at 25. Although not clear in his opening brief, North previously argued that the Hearing Officer's bias became evident during the hearing based on his rulings. R. at 5057; Decision at 18. North, however, waived any argument that he may have had concerning the Hearing Officer's bias by failing to file a motion to disqualify the Hearing Officer when he was afforded an opportunity to do so. *See* FINRA Rules 9233(b) and 9234(b).

North's assertion of bias also is wholly unsubstantiated by the record and thus "an insufficient basis to invalidate" the proceeding below. *See Dist. Bus. Conduct Comm. v. Guevara*, Complaint No. C9A970018, 1999 NASD Discip. LEXIS 1, at *39 n.16 (NASD NAC Jan. 28, 1999), *aff'd*, 54 S.E.C. 655 (2000), *aff'd*, 47 F. App'x 198 (3d Cir. 2000). North is basing his claims of bias on the Hearing Officer's and the NAC subcommittee's adverse rulings, including the rejection of his proffered experts, the ruling about the relevancy of emails, and the

---

[18] Now, on appeal before the Commission, North asserts that the FINRA Enforcement attorney, Mark Fernandez, and FINRA Chief Deputy Hearing Officer, also "participated either directly or indirectly" in the proceedings involving Cowle and is additional indicia of bias. Applicant's Br. at 25. The Commission should disregard North's additional claim of bias raised for the first time on appeal.

denial of his motion to adduce additional evidence. But adverse rulings alone do not evidence bias. *See Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *62 (Jan. 30, 2009), *aff'd*, 416 F. App'x 142 (3d Cir. 2010). In fact, the record in this case provides no support for North's argument that the Hearing Officer or the NAC subcommittee were biased against him. Rather, the record demonstrates that the Hearing Officer and the NAC subcommittee based their rulings on the record, and that the Hearing Panel and the NAC imposed liability against North based on that evidence.

5. North's Constitutional Arguments and Other Federal Statutory Challenges Fail

North argues that FINRA and Smarsh violated the Fourth Amendment and a variety of federal criminal statutes, including those related to mail and wire fraud and the destruction of records in federal investigations, and committed numerous torts. Applicant's Br. at 37-44. These arguments fail.[19]

It is well settled that FINRA is not a state actor, so it is not subject to constitutional requirements. *See McCune*, 2016 SEC LEXIS 1026, at *37 n.52. In addition, the criminal statutes and torts cited are irrelevant to the issue of whether North violated NASD Rules 3070 and 3010, FINRA Rule 2010, and MSRB Rule G-27, as found by the NAC. *See North*, 160 F. Supp. 3d at 77 (determining that North had no private right of action to enforce criminal obstruction of justice statutes and that these laws do not apply to FINRA); *see also North v. Smarsh, Inc.*, Civil Action No. 15-494 (D.D.C. Jan. 21, 2016) (denying North's motion to amend his complaint against Smarsh and FINRA alleging other federal mail and wire fraud violations as

[19] These same and similar arguments were explicitly rejected by the NAC in its decision. Decision at 18 n.29.

well as conspiracy to convert and tortious conversion of electronic data and conspiracy to spoliate and tortious spoliation of electronic data).[20] The NAC decision is well founded and based on the evidence in the record, not contrived conspiracy theories. The Commission should affirm the NAC's findings and dismiss North's application for review.

F. The NAC's Sanctions Are Consistent With FINRA's Sanction Guidelines and Are Neither Excessive Nor Oppressive

For North's collective misconduct, the NAC fined North $40,000, imposed a 30-business-day suspension in all principal and supervisory capacities followed by a two-month suspension in all principal and supervisory capacities. Decision at 24. On appeal, North does not directly contest these sanctions. Nor should he. The sanctions are supported by the facts in this case, are consistent with the Guidelines, are neither excessive nor oppressive, and serve the public interest.

Section 19(e)(2) of the Exchange Act guides the Commission's review of FINRA's sanctions, and provides that the Commission may eliminate, reduce, or alter a sanction if it finds that the sanction is excessive, oppressive, or imposes a burden on competition not necessary or appropriate to further the purposes of the Exchange Act.[21] *See Jack H. Stein*, 56 S.E.C. 108, 120-21 (2003). The Commission considers the principles articulated in the Guidelines and has regularly affirmed sanctions that are within the recommended ranges contained in the relevant Guidelines. *See Midas Sec., LLC*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *61 n.85 (Jan. 20, 2012); *Robert Tretiak*, 56 S.E.C. 209, 233 (2003).

---

[20] The Commission may take official notice of North's federal action. *See* SEC Rule of Practice 323, 17 C.F.R. § 201.323.

[21] North does not contend, and the record does not show, that the sanctions are an undue burden on competition.

In determining that a sanction is remedial, and not excessive or oppressive, the Commission need not be convinced that a lesser sanction would be sufficient or that FINRA has imposed the least onerous sanction available. *See PAZ Sec., Inc. v. SEC*, 566 F.3d 1172, 1176 (D.C. Cir. 2009). Indeed, the Guidelines direct adjudicators to design sanctions that are significant enough to ensure effective deterrence and to "exercise judgment and discretion" and tailor sanctions to "achieve deterrence and remediate misconduct." *See FINRA Sanction Guidelines* 2-3 (2016), http://www.finra.org/sites/default/files/2016 _Sanction_Guidelines.pdf (hereinafter "*Guidelines*") (General Principles Applicable to All Sanction Determinations, Nos. 1, 3). Here, the NAC carefully balanced all mitigating and aggravating factors and imposed sanctions that are appropriately remedial and correctly reflect the gravity of North's misconduct.

1. The NAC Appropriately Sanctioned North for His Failure to Report an Associated Person's Relationship with a Statutorily Disqualified Individual

The NAC fined North $10,000 and imposed a 30-business-day suspension in all principal and supervisory capacities for failing to report King's relationship with a statutorily disqualified individual. These sanctions, which are within the recommended range under the Guidelines, are neither excessive nor oppressive, and they should be affirmed by the Commission.

For the failure to report a relationship with a statutorily disqualified person, the Guidelines recommend a fine of $5,000 to $146,000 and a suspension of the responsible principal in all supervisory capacities for 10 to 30 business days. *Id.* at 73. In egregious cases, the Guidelines recommend that adjudicators consider suspending the responsible principal in any or all capacities for up to two years or barring the responsible principal in all supervisory capacities. *Id.* The Guidelines instruct adjudicators to consider whether the unreported event would have established a pattern of potential misconduct. *Id.* Adjudicators also are instructed to

consider the principal considerations and general principles applicable to all violations. *Id.* at 2-7.

The NAC appropriately considered a number of factors in assessing the appropriate sanctions for North misconduct. Decision at 20. The NAC first considered that it was aggravating that North's failure to investigate the KAM-UTA service agreement in March 2010 prevented North from discovering King's relationship with a statutorily disqualified individual. *Id.* The NAC considered North's failure to report King's relationship shortly after March 2010 at least negligent, and his later failure to report King's relationship in December 2010 intentional and further aggravating under the Guidelines. *Id.* The NAC also considered it aggravating that North failed to accept responsibility for his misconduct, insisting that his conduct was not violative and FINRA was responsible.[22] Decision at 20. The NAC also noted that the reportable events NASD Rule 3070 are important regulatory information for FINRA. *Id.* (citing *NASD Notice to Members 96-85*, 1996 NASD LEXIS 107, at *3 (Dec. 1996) (noting that information reported by members pursuant to NASD Rule 3070 "provides [FINRA] with important regulatory information that assists with the timely identification of problem members, branch offices, and registered representatives to detect and investigate potential sales practice violations")).

---

[22] On appeal before the NAC, North argued that he was not obligated under NASD Rule 3070 to report King's relationship because FINRA was already aware of it at the time. Decision at 7. There is no evidence that FINRA was aware of the relationship before December 2010. Moreover, as explained in the NAC's decision, whether FINRA may have been aware of information that is subject to reporting under NASD Rule 3070(a) does not excuse noncompliance with NASD Rule 3070's reporting requirements. *See, e.g., Dep't of Enforcement v. Inv. Mgmt. Corp.*, Complaint No. C3A010045, 2003 NASD Discip. LEXIS 47, at *21-23 n.21 (NASD NAC Dec. 15, 2003) ("Even if NASD had received notice through [another means] in a timely manner, that does not excuse the respondents from their obligation to notify NASD under Rule 3070.").

After considering all of these factors, and in particular the possibility that North's failure to disclose the relationship allowed King's pattern of misconduct with Cowle to continue, the NAC concluded that the $10,000 fine and a 30-business-day suspension in all principal and supervisory capacities struck an appropriate balance and served the public interest.[23] Decision at 19-20.

2. The NAC Appropriately Sanctioned North for His Failure to Establish a Reasonable Supervisory System for the Review of Electronic Correspondence

The $10,000 fine imposed by the NAC on North for his failure to establish a reasonable supervisory system for the review of electronic correspondence also is consistent with the Guidelines and should likewise be affirmed.

For deficient written supervisory procedures, the Guidelines recommend a fine of $1,000 to $37,000. *Guidelines*, at 103. In egregious cases, the Guidelines recommend suspending the responsible individual in any or all capacities for up to one year. *Id.* In evaluating the appropriate sanctions to impose, the Guidelines offer two principal considerations, one of which is relevant here: whether deficiencies allowed violative conduct to occur or to escape detection. *Id.* The NAC appropriately applied these conduct-specific Guidelines and the principal considerations applicable to all violations. Decision at 21-22.

Noting that North was responsible for establishing and maintaining a reasonable supervisory system at Southridge for the review of electronic correspondence, the NAC found that North's supervisory failures were serious. *Id.* at 21. The NAC considered that the deficient procedures allowed violative conduct to continue because they contributed to North's inadequate

---

[23] The Hearing Panel's 30-business-day suspension was in all principal capacities only. The NAC amended the Hearing Panel's order to include a 30-business-day suspension in all supervisory capacities. Decision at 20 n.39.

review of electronic correspondence, positing that North's review of correspondence may not have been so haphazard if the procedures had been adequate. *Id.* at 21; *Guidelines,* at 103.

The NAC found it aggravating that the deficiencies in the written supervisory procedures persisted over a two-year period and included two sets of written supervisory procedures. Decision at 21; *Guidelines,* at 6. The NAC balanced this factor with the fact that Southridge's procedures, while inadequate, were tailored to its business. Decision at 21. The NAC noted, however, that both sets of procedures failed to take into account the particulars of Southridge, including the size of the firm, the nature of its business, and the fact that many registered representatives used Bloomberg communications to communicate. *Id.* at 21 (citing *FINRA Regulatory Notice 07-59*, 2007 FINRA LEXIS 58, at *32). The NAC found these deficiencies, along with the incomplete and unmodified template in the 2010 procedures, aggravating. *Id.* at 22.

Under the circumstances, the NAC determined that a $10,000 fine—a sanction at the lower end of the Guidelines' range for monetary sanctions—was appropriately remedial for North's negligent misconduct.[24]

3. The NAC Appropriately Sanctioned North for His Failure to Adequately Review Electronic Correspondence

Finally, the Commission should affirm the $20,000 fine and two-month suspension in all principal and supervisory capacities that the NAC imposed on North for his failure to adequately review electronic correspondence. Decision at 23. After weighing all factors, the NAC

---

[24] The NAC eliminated the censure imposed by the Hearing Panel because FINRA generally does not censure associated persons when a suspension is imposed. Decision at 22; *see also NASD Notice to Members 99-91*, 1999 NASD LEXIS 121, at *6-7 (Nov. 1999); *Guidelines*, at 9.

appropriately concluded that North's misconduct was egregious and warranted significant sanctions, particularly in light of the "several aggravating factors." *Id.* at 23.

For a failure to supervise, the Guidelines recommend a fine between $5,000 and $73,000 and a suspension of the responsible individual in all principal capacities for up to 30 business days. *Guidelines*, at 102. In egregious cases, the Guidelines advise adjudicators to consider imposing a longer suspension in all capacities or barring the responsible individual. *Id.* The Guidelines provide three principal considerations: (1) whether respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny; (2) the nature, extent, size and character of the underlying misconduct; and (3) the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls. *Id.*

The NAC detailed the several aggravating factors in its decision. Decision at 23. First, the NAC explained that North ignored red flags—e.g., the KAM-UTA service agreement and invoices—that should have resulted in additional supervisory scrutiny of King's electronic communications. *Id.* at 23; *Guidelines*, at 102. Second, the NAC found that the fact that none of North's searches on the Smarsh SMC produced Bloomberg communications also should have been a red flag to him that his electronic communication review was inadequate. Decision at 23. Third, the NAC found that North, as the responsible principal for the review of electronic correspondence at Southridge, was in in the best position to understand how his implementation of the review of the firm's electronic correspondence was lacking. Yet he failed to discharge his responsibilities. Decision at 23. North never reviewed any Bloomberg communications during the relevant period, and his review of emails also was inadequate considering the size of Southridge, the number of registered representatives, and the total amount of emails exchanged during the relevant period. Decision at 23; *Guidelines*, at 102. Fourth, the NAC noted that

North's misconduct persisted over an extended period of time, and he compounded the problem of Southridge's inadequate supervisory procedures by his deficient review. Decision at 23; *Guidelines*, at 6.

After weighing all factors, the NAC appropriately concluded that North's misconduct was egregious and reckless and warranted significant sanctions. Decision at 23; *Guidelines*, at 7, 102. North's two-month suspension in all principal and supervisory capacities and $20,000 fine—which is consistent with the Guidelines—serves the public interest by encouraging future compliance by North and others in the securities industry with supervision rules and guidance governing the review of electronic communications.[25] *See Robert E. Strong*, Exchange Act Release No. 57426, 2008 SEC LEXIS 467, at *48 (Mar. 4, 2008) ("[W]e believe that the sanctions imposed by NASD serve the public interest by encouraging future compliance with the rules at issue here, by Strong and by others in the industry who have been given similar responsibilities."). The sanctions will deter North and similarly situated individuals from effectively abdicating their obligation to exercise reasonable supervision. *See John B. Busacca, III*, Exchange Act Release No. 63312, 2010 SEC LEXIS 3787, at *67 (Nov. 12, 2010), *aff'd*, 449 F. App'x 886 (11th Cir. 2011).

V. CONCLUSION

North failed to report an associated person's relationship with a statutorily disqualified individual, willfully failed to establish and maintain a reasonable supervisory system for the review of electronic correspondence, and willfully failed to adequately review electronic

[25] For his misconduct, the Hearing Panel fined North $20,000 and imposed a two-month suspension in all principal capacities only. The NAC amended Hearing Panel's order to include a two-month suspension also in all supervisory capacities.

correspondence. North's unsubstantiated claims about conspiracy and spoliation are a distraction from an otherwise simple matter. The evidence of North's misconduct is abundant and clear. The sanctions imposed by FINRA also are supported fully by the record and serve to remediate North's misconduct in accordance with the Guidelines. The Commission therefore should dismiss the application for review, sustain FINRA's disciplinary action, and affirm the sanctions it imposed.

Respectfully submitted,

Megan Rauch
Assistant General Counsel
FINRA
1735 K Street, NW
Washington, DC 20006
(202) 728-8863

Dated: July 14, 2017