UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Admin. Proc. File 3-17909

In the matter of the Application of **THADDEUS J. NORTH** **For Review of Disciplinary Action Taken** **by FINRA**	**REPLY BRIEF** **IN SUPPORT OF** **APPLICATION FOR REVIEW**

Submitted this 27th day of July 2017 on behalf of Thaddeus J. North

by _____

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REPLY BRIEF

I. The Hearing Officer abused his discretion and committed reversible error.

The legal issues and discussion that Applicant Thaddeus J. North ("Mr. North") advances is whether the FINRA Hearing Panel and National Adjudicatory Counsel ("NAC") Panel decisions are reversible for error, and not excused as proper exercise of discretion. Although FINRA and NAC Hearing Officers derive broad discretion from FINRA's status as a self-regulatory organization, are not required to apply the Federal Rules of Evidence, and FINRA is not deemed a "state actor," it is a legal entity. As such, FINRA and its employees have a duty to adhere to the laws of the United States in fulfilling their duties. In this case, credible third party evidence was presented to the Hearing Officer and NAC subcommittee[1] that conduct of FINRA employees, agents, or trusted sources, such as Smarsh Inc. ("Smarsh"), was illegal and tortious.

A. The Hearing Officer committed reversible error by admitting the Smarsh Reports and disallowing evidence in Mr. North's defense.

Mr. North contends that the Hearing Officer abused his discretion and committed reversible error by admitting the compliance action reports allegedly prepared by Smarsh ("Smarsh Reports") and denying him the opportunity to present expert and non-expert testimony regarding the source and handling of the Southridge Investment Group LLC ("Southridge") firm's brokers' Email and to challenge the data used to prepare the Smarsh Reports. Mr. North reasons that reversible error occurred when, but for wrongful exercise of discretion about admissibility of evidence and testimony, the outcome of FINRA and NAC decisions would have been different. Further, proper exercise of discretion results in no more than *harmless error* or error that has no or *de minimis* impact on the outcome of legal proceedings, meaning the

[1] *See, e.g.*, Record ("R.") 000525-000532, 000835-000840, 002079-002167, 002433-002470, and 003955-004984.

outcome of the process would be the same regardless of the alleged error.

1. Harmless error does not affect substantive rights and outcomes.

FINRA Rule 9235 (g) recognizes the principles of harmless error, which the law and courts describe as "any error, defect, irregularity or variance which does not affect substantial rights ...."[2] In other words, a technical error, defect or exception is a "nonconstitutional trial error [that] is harmless unless it "had substantial and injurious effect or influence..."" *e.g.*, altering the outcome of a legal proceeding.[3] The Supreme Court observed that an error is harmless when, "after pondering all that happened without stripping the erroneous action from the whole, that the judgment was not substantially swayed by the error."[4] Even constitutional error may be disregarded when the error "was harmless beyond a reasonable doubt."[5]

Mr. North urges that, but for the Hearing Officer's abuse(s) of discretion in admitting or excluding evidence that resulted in reversible error, the Enforcement proceedings would have had an opposite outcome from the judgment and penalties rendered by the Hearing Panel and, likewise, the NAC Panel, due to its deference to the Hearing Panel findings and conclusions. Throughout the Enforcement proceedings the Hearing Officer dismissed Mr. North's concerns about the admissibility of electronically stored information ("ESI") and thereby avoided inquiry about the causes of spoliation to the ESI, *e.g.*, Email, and other anomalies in the Email and Email metadata Enforcement delivered to Mr. North and LK during the Enforcement proceedings.[6]

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[2] *See* Fed.R.Crim.P. 52 (a). *See also Kotteakos v. United States*, 328 U.S 750, 757, 776 (1946).

[3] *U.S. v. Lowery*, 135 F.3d 957, 959 (5th Cir. 1998) (error to grant the motion in limine and subsequent rulings because of the impact on the jury's verdict).

[4] *Kotteakos*, 328 U.S. at 765. *See also United States v. Johnson*, 617 F.3d 286, 292 (4th Cir. 2010) (erroneous fact-finding and applying erroneous legal principles are an abuse of discretion); *United States v. Brooks*, 111 F.3d 365, 371 (4th Cir. 1997).

[5] *Chapman v. Californ*ia, 386 U.S. 18, 24 (1967) (admitting highly prejudicial evidence is not harmless error).

[6] *See supra* note 1.

After Mr. North argued that the condition and content of the ESI did not support FINRA's claims,[7] Enforcement abandoned use of the Email and its content. In support of Enforcement, the Hearing Officer precluded expert testimony about the condition of the Email, the content of its metadata, and the cause(s) of the apparent archiving failures that resulted in the Email appearing spoliated.[8] Mr. North objected on foundation grounds that the Smarsh Reports were inadmissible and unreliable, because the underlying electronic records, including all allegedly archived Emails were not disclosed by Enforcement and server administrative files or logs in support of the Smarsh Reports, were not made available.[9] Over objection, the Hearing Officer admitted the Smarsh Reports by allowing the last minute telephonic testimony of Smarsh witness Robert Sherman, who testified that the underlying Smarsh Management Console ("SMC") files from which the Smarsh Reports were allegedly derived were lost to migration or unsuccessful re-ingestion or both."[10] The fact that the Smarsh Reports were derived from ESI, which Smarsh witness Sherman testified was lost, should have caused the Hearing Officer to disallow the admission of *any* reports derived from the alleged SMC.[11] Instead, the Hearing Officer admitted the reports without sufficient foundation for admissibility and reliability. It is now known that the Smarsh Reports were created using non-Y2K compliant federal government resources to which Smarsh has no access.[12]

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[7] R. 000835-000840, 003955-004984.
[8] R. 002253-002254.
[9] R. 002433-002446.
[10] R. 002609-002620. *See also* R. 002635 (Apr. 13, 2015 Hr'g Tr. 114-116, 157-173).
[11] *Id.* (Apr. 13, 2015 Hr'g Tr. 114-116).
[12] R. 003755-003931 (Ex. 4 at 3-5; Ex. 6 at 35-37, 106-107).

2. The Smarsh Reports prejudicially influenced the FINRA Hearing and NAC Panels' treatment of the WSP and NASD Rule 3070 issues.

Therefore, to make it appear that Mr. North lied, it must have been FINRA employees who created and tailored the reports to impeach the firm's description of Mr. North's compliance in 2011,[13] Mr. North's testimony in on the record interviews in 2012,[14] and at the 2015 hearing.[15] Otherwise, Mr. North's testimony and the firm's[16] description about his use of ten or fifteen percent random samples and lexicon searches were consistent among themselves and neither describes a violation of any FINRA or SEC or MSRB rule. The Smarsh Reports so damaged Mr. North's credibility that the Hearing Panel judged him with unnecessary harshness and the NAC Panel even more so.[17]

Absent the Smarsh Reports to impeach Mr. North, a simple mistake—not designating a specific percentage in a 450 page plus written supervisory procedures ("WSP") developed from a template designed specifically for the securities industry—would be viewed as a scrivener's and or template design error. Mr. North's preparation of the 2010 WSP in the interest of improving on the version[18] that was in place when Mr. North joined the Southridge firm in 2008 was not a willful rule violation. However, the Smarsh Reports allowed the Hearing Panel to wholly discredit the firm's and Mr. North's described practice as what both believed were adherence to FINRA rules and the Southridge WSP. The Smarsh Reports also allowed the Hearing Panel to ignore that fact that a WSP is a document that is meant to and should be corrected and modified as a firm's business priorities, environment, and laws change, and technical errors are identified.

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[13] R. 003465-003480 (CX-3 at 9-10).
[14] R. 002913 (Apr. 14, 2015 Hr'g Tr. 296-301, 337-342).
[15] *Id.*
[16] *See, e.g.*, R. 003465-003480 (CX-3 at 9-10).
[17] R. 005151-005180.
[18] R. 003535-003582 (CX-10 at 20).

Likewise, the Smarsh Reports allowed the Hearing Panel to ignore the ineffectiveness of the SMC and defects in Enforcement's evidence: no Email content and nothing in the Smarsh Reports, as an independent source of information, put Mr. North on notice about the alleged Services Agreement and invoices reflecting an arrangement between LK and TC as a basis for making a Rule 3070 report. Because the SMC was nonexistent,[19] Enforcement tendered no Email to support any inference that Mr. North would have discovered evidence of the LK-TC contract, invoices or arrangements from conducting Email review more frequently or differently.

Other than examining LK's disclosures to the firm, her daily transactions and Email, the only reasonably accessible source of information about the alleged LK-TC arrangement was LK and TC themselves. Enforcement presented no evidence that LK admitted to any person at any time prior to entering into settlement with FINRA in March 2015[20] that she and TC were engaged in an unlawful practice or association.

Ad hoc, the FINRA Hearing and NAC Panels imposed management duties and decisions on Mr. North that were not his to make. Mr. North had no authority over TC or to question third party brokers transacting with LK, foreclosing the idea that an independent investigation by Mr. North would have revealed anything different than what was learned by CEO Schloth as the basis for Southridge management's conclusion that no NASD Rule 3070 report should be made. FINRA provided no evidence that Mr. North had management duties under any FINRA rule or by any Southridge corporate document to undertake a parallel investigation to CEO Schloth's on behalf of management, or to utilize different resources than he had at his disposal.

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[19] The SMC could not exist because Smarsh does not own, control or operate any servers.
[20] R. 002383-002406.

II. The NAC subcommittee abused its discretion, compounded the errors made by the Hearing Officer, and committed reversible error.

The NAC likewise has broad discretion to allow the introduction or adducement of new evidence.[21] In this case, the NAC was provided extensive information, most of which became available only after the April 13-14, 2015 Enforcement hearing.[22] The new evidence Mr. North tendered proves there were violations of law, *e.g.*, Electronic Communications Privacy Act[23] and Y2K Act,[24] fraud upon a member firm due to Smarsh's failure to archive Email as it contracted to do, and FINRA's misuse of federal government non-Y2K equipment and software,[25] to which Smarsh did not have access for storing data and to create the Smarsh Reports given its formation after 2001.[26] In this case, the NAC subcommittee committed reversible, not harmless error, and therefore, abused its discretion by declining the admission or adducement of additional or new evidence; the outcome of the NAC panel would have been different had the evidence been admitted, for similar reasons as discussed above regarding the Hearing Panel's order.

The NAC Panel would have learned from the new evidence why the Smarsh Reports were inadmissible and why there was no supporting data for the Smarsh Reports. Mr. North's expert, Frank Huber concluded, FINRA received all of the Email and attachments in real time, and therefore it controlled all of the ESI—Email, attachments, and Smarsh Reports. This conclusion is unavoidable because: (1) Smarsh did not have the intent or ability to archive Email or support the alleged SMC, because it does not own, operate or control any servers according to

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[21] FINRA Rule 9346 (b).
[22] R. 003755-003930.
[23] 18 U.S.C. §§ 2510-2521 (2012).
[24] 15 U.S.C. §§ 6601-6617 (2012).
[25] R. 3755-003930 (Ex. 4 at 3-5; Ex. 6 at 35-37, 106-107).
[26] Smarsh's registration is a matter of public record. *See, e.g.,* https://icis.corp.delaware.gov/ECORP/EntitySearch/NameSearch.asapx; https://appext20.dos.ny.gov/corp_public/CORPSEARCH.ENTITY_SEARCH_ENTRY.

ARIN and IANA;[27] and (2) federal government non-Y2K compliant resources were used[28] to store unlawfully intercepted Southridge employee Email and to prepare the Smarsh Reports.

Mr. North contends that the NAC Panel conclusions regarding the WSP resulted from the false impression(s) created by the Smarsh Reports, because the panel discredited Mr. North's testimony about his compliance practices. The panel did not consider that Mr. North's description reflected his understanding about compliance and the protocols he reasonably believed were reflected in the WSP. The false impression allowed the Hearing and NAC Panels to treat a single scriveners error (or other perceived deficiencies) as rule violations, ignoring the obvious—had Mr. North realized the scrivener's error(s) he would have corrected them before a copy was delivered by FINRA and that WSPs must be modifiable in an evolving business environment and correctable for unavoidable oversights that arise when working with comprehensive and lengthy documents.

Further, had the evidence of FINRA's procurement of Smarsh to engineer the illegal interception of Email been admitted for the NAC Panel's consideration, the NAC could not avoid the illegality of FINRA's and Smarsh's conduct and how their actions sabotaged the firm's compliance—they stole Email and thereby prevented Email and Email review from being a reliable source of information for Mr. North or any other principals of the firm who had the duty to review Email for securities law violations and potential NASD Rule 3070 disclosures.

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[27] ARIN is American Registry for Internet Numbers; IANA is the Internet Assigned Numbers Authority.

[28] *See* Opening Brief at 12 regarding the admission by FINRA Boston District examiner James McKennedy in the related complaint involving Ocean Cross Capital Markets, LLC ("Ocean Cross") regarding access to federal government non-Y2K compliant resources to fix the Smarsh Reports. Smarsh allegedly archived consecutively for Southridge and Ocean Cross; therefore, non-Y2K compliant resources were used throughout both contractual relationships, explaining why the Southridge and Ocean Cross Email and reports disclosed by FINRA demonstrate similar evidence of handling and alteration.

III. The totality of the decisions made in the Enforcement proceedings reflects bias.

Not a single event, but the entire record demonstrates bias—from the pre-hearing relationships among the Hearing Officers and Enforcement prosecutor presenting this case to the totality of the Hearing Officer's rulings[29]—that prevented the introduction of evidence of FINRA's and Smarsh's unlawful and illegal conduct to achieve the outcome now on appeal in Mr. North's defense. The Hearing Officer's bias was revealed over time in decisions that gradually foreclosed Mr. North's ability to present third party evidence to refute most if not all of FINRA's claims respecting alleged violations of FINRA, NASD, and MSRB rules.[30]

In reviewing for bias, appellate courts "presume that a judge will set aside personal views—which given human nature are always present—and find the relevant facts solely on the evidence presented. An appellant therefore must show that a judge's mind was "irrevocably closed" on the issue before the court."[31] The Hearing Officer demonstrated that his mind was irrevocably closed to any evidence not related to what Mr. North did or did not do as opposed to the condition of Email and Email archiving.[32] Due to the Hearing Office's training and experience he knew or should have known that regulatory compliance archiving must not change characteristics or content of electronic communications, that Email queries also search metadata, and that Email metadata stores transportation, server and processing information.

The metadata associated with the Email FINRA disclosed in this case reveals that it was processed at two large data centers in New City's financial district. The primary datacenter is

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[29] *See, e.g., supra* note 1. In a heavy-handed exercise of authority, the Hearing Officer ordered LK to turn over a professionally wiped hard drive. R. 00887-00932, 001035-001040.

[30] *See supra* note 1.

[31] *S.E.C. v. First City Financial Corp., Ltd.*, 890 F.2d 1215, 1223 (D.C. Cir. 1989).

[32] R. 002253-002254, 002371-002376, 002519-002520, 002635 (Apr. 13, 2015 Hr'g Tr. 6-53; 170-173, 231-234).

located at 75 Broad Street, New York City,[33] and belongs to Internap, FINRA's Internet Service Provider ("ISP").[34] The second site identified is located within a few blocks at 25 Broadway.[35] Neither of these locations are associated with Smarsh; neither Southridge nor Southridge's ISP has an office or other physical location at either of these New York City locations.

The new evidence tendered to the NAC explains the cause(s) of what was originally thought to be spoliation, but was later found to be an unlawful scheme to intercept brokers' Email. Mr. North contends that the NAC subcommittee's refusal to admit or adduce the new evidence reflects its bias in favor of FINRA, because the new evidence proves that FINRA received Southridge firm's brokers' Email in real time and was the only entity that actually received the data, not Smarsh the alleged archivist and host of the alleged SMC.

Enforcement has not refuted the evidence of its wrongful conduct; it has presented no credible, independent third party to prove the authenticity of any ESI or ESI derived evidence, *e.g.*, the Smarsh Reports. Mr. North pursued federal district court action(s) and these appeals because he is the victim of Smarsh's fraud—there was no archive and no SMC, and therefore, no legitimate Smarsh Reports—and the victim of Enforcement's fraud on the FINRA Hearing Panel and NAC Panel—Enforcement introduced false testimony and contrived evidence.

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[33] *Compare* R. 003755 (Ex. 8 (Email instructions from Smarsh); Ex. 3 at 12, Attachment 4 at 5, 6; Ex. 5, Huber at 8 ("25 [sic] Broad and 25 Broadway)") *with* https://whois.arin.net/rest/net/NET-64-34-0-0-1/pft?s=64.34.12.0. *See also* http://www.datacentermap.com/USA/new-york/internap-75-broad.html; https://therealdeal.com/2016/12/19/jemb-shopping-50-stake-in-75-broad/).

[34] *See* http://www.ip-tracker.org/locator/ip-lookup.php?ip=Fsg.finra.org; https://db-ip.com/75.98.61.48.

[35] *See* https://cloudandcolocation.com/datacenters/telehouse-new-york-data-center-25-broadway/; https://www.datacenterhawk.com/colo/cogent/25-broadway/135870; R. 003755 (Ex. 3 at 12 and Attachment 4 at 5, 6; Ex. 4 at 6-7 and Huber Ex. 1 (ARIN Whois Resolve – Exhibit 28, page 7)).

IV. The reversible errors and unlawful conduct make all sanctions unreasonable.

No discussion of the rules will change the unreasonableness of the sanctions given that the claims against Mr. North were contrived from illegally obtained evidence, which was altered or made up to suggest securities laws violations. FINRA's suggestion that Mr. North should have accused the Hearing Officer of bias (or abuse of discretion) during the Enforcement hearing is a red herring and would likely have inflamed rather than stop further exercise of bias. Mr. North urges that the Hearing Officer's abuses of discretion in the admission of evidence resulted in reversible error(s) and rendered the sanctions issued by the Hearing Panel unreasonable. Likewise, because the NAC Panel deferred to the erroneous conclusions reached by the Hearing Panel and refused new evidence, the NAC Panel enhanced sanctions are also unreasonable.

V. Conclusion

Despite FINRA's status as an SRO, no authority allows it to violate the law, make up evidence, create false charges from false evidence, and hide its misconduct under the guise of broad discretion and control over the record. In conclusion, Mr. North urges that the NAC Panel decision be reversed in its entirety, because the panel decision relied on a record containing substantive and reversible errors made by the Hearing Officer and because of the Hearing Officer's bias to favor FINRA Enforcement. Further, as a result of FINRA Enforcement's illegal and unconstitutional conduct, Mr. North also prays that he be reimbursed for all expenses and legal fees incurred and that his record be expunged of all references to this disciplinary action.

Respectfully submitted this 27th day of July 2017 for THADDEUS J. NORTH

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CERTIFICATE OF SERVICE

Notice is hereby given that on this 27th day of July 2017, undersigned Counsel sent the foregoing Reply Brief of Thaddeus J. North before the Securities and Exchange Commission, In the Matter of Thaddeus J. North, by certified first class USPS mail to the following:

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Attention: Megan Rauch
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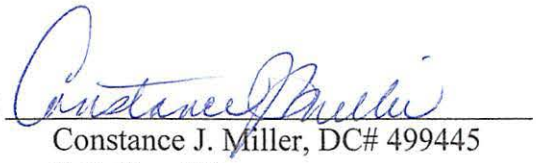
For THADDEUS J. NORTH

by: 

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