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UNITED STATES OF AMERICA
BEFORE THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Application of

SCOTTSDALE CAPITAL ADVISORS CORPORATION, JOHN J. HURRY, TIMOTHY B. DIBLASI, AND D. MICHAEL CRUZ

For Review of Disciplinary Action Taken by FINRA

3-18612

OPENING BRIEF FOR APPEAL OF TIMOTHY B. DIBLASI AND SCOTTSDALE CAPITAL ADVISORS

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Petitioners Timothy B. DiBlasi ("Mr. DiBlasi") and Scottsdale Capital Advisors ("SCA") appeal the decision of the National Adjudicatory Counsel ("NAC") dated July 20, 2018 in FINRA Complaint No. 2014041724601. SCA is a broker-dealer focused on microcap securities which was co-founded by Petitioner John Hurry. Mr. DiBlasi is SCA's Chief Compliance Officer ("CCO"). The NAC found that Mr. DiBlasi and SCA violated NASD Rule 3010 and FINRA Rule 2010 for failing to establish and maintain written supervisory procedures ("WSPS") that were reasonably designed to ensure compliance with Section 5 of the Securities Act of 1933 (the "Securities Act"). As a result, the NAC suspended Mr. DiBlasi from associating with any FINRA member firm for two years and fined him $50,000; the NAC fined SCA $250,000 in part because of this supervisory violation.

For the reasons discussed herein, the Commission should reverse the NAC's decision with respect to Mr. DiBlasi and SCA.

I. EXECUTIVE SUMMARY

Mr. DiBlasi is collateral damage in FINRA's ongoing, win-at-absolutely-any-cost campaign against SCA and its co-founder, John Hurry. In its zeal to try to kick Mr. Hurry out of the securities industry, FINRA's Department of Enforcement ("Enforcement") brought now debunked charges against Mr. Hurry for violating Section 5 of the Securities Act. Enforcement apparently presumed that if Mr. Hurry and SCA violated Section 5, then certainly Mr. DiBlasi, as SCA's CCO, must have somehow been derelict in his duties.

In charging Mr. DiBlasi, however, FINRA ignored the uncontroverted evidence that he had no responsibilities whatsoever with creating the written policies and procedures regarding whether to approve the sales of unregistered stock (Rule 144 procedures). Instead, his duties and responsibilities were focused on the firm's anti-money laundering ("AML") program, which is not

an issue in this case, and in keeping up to date with the firm's numerous regulatory filings, including the Form BD and Form U4s.

Thus, despite FINRA's protestations to the contrary, the NAC's imposition of liability on Mr. DiBlasi is premised merely on the fact that he held the title of Chief Compliance Officer and is not tied to any potential failings with respect to the areas over which he had responsibility. Accordingly, the Commission should reverse the findings of liability against Mr. DiBlasi and SCA and the related sanctions.

II. STANDARD OF REVIEW

When a broker-dealer appeals the disciplinary findings of a self-regulatory organization ("SRO"), the Commission conducts an independent review of the record. *In re Lane & Lane*, Exchange Act Rel. No.74269,2015 WL 627346, at *5 (S.E.C. Feb. 13, 2015); *In re Cespedes*, Exchange Act Rel. No. 59404, 2009 WL 367026, at *6 (S.E.C. Feb. 13, 2009). The Commission must overturn the SRO's decision if a preponderance of the evidence does not support its findings. *Id.* Even if the Commission affirms the factual findings of the SRO, it may reduce or cancel the sanctions as it sees fit. 15 U.S.C. § 78s(e)(2).

III. INTRODUCTION

SCA is a market-leading broker-dealer in microcap-securities trading. Enforcement alleges that, between December 2013 and June 2014 (the "Relevant Period"), a small number of foreign financial institutions, on behalf of their own customers, deposited and unlawfully sold unregistered stock at SCA through Cayman Securities Clearing and Trading SEZC Ltd. ("CSCT"), a Cayman Islands-based broker-dealer established by Mr. Hurry.

Mr. DiBlasi is SCA's CCO. He has worked in the securities industry for 16 years, holds Series 6, 7, 24, 27, 53, 63, and 99 licenses, and has a pristine disciplinary record. Before joining

SCA in 2012, Mr. DiBlasi served in the 82nd Airborne Division of the United States Army and worked for First Investors Corporation. He also holds a B.S. in Business Finance.

The process of evaluating whether deposits of unregistered stock could be sold was one of the few aspects of the firm in which Mr. DiBlasi was not involved. The uniform testimony in this case confirms that point. Yet FINRA has chosen to disregard that reality, without any witness corroboration, because a line in an appendix to the version of the WSPs that was already in existence when Mr. DiBlasi became CCO said that the CCO was responsible for the firm's Rule 144 procedures.[1] That statement was inaccurate and all of the evidence shows that SCA personnel were aware of that inaccuracy. Indeed, at the same time Mr. DiBlasi became CCO, draft revisions to the WSPs were underway that fixed the mistake. The revised WSPs were issued a few months later.

Importantly, SCA had in place a detailed Rule 144 manual that operated as the firm's written policies and procedures with respect to Section 5 compliance. This is not a situation where there was some gap because of confusion as to who was responsible for creating and maintaining the Rule 144 manual.

Ruining Mr. DiBlasi's career on a theory that the regularly scheduled annual update to the WSPs should have been accelerated by a couple of months under these circumstances accomplishes no rational regulatory objective. The Commission should reverse the NAC's decision.

[1] Rule 144 is a safe harbor that permits the sale of unregistered securities.

IV. THE NAC'S FINDINGS IGNORED UNCONTESTED EVIDENCE AND RELIED ON INCORRECT INFORMATION

A large component of SCA's business consists of processing trades in microcap securities. Sometimes those trades consist of unregistered securities. Section 5 of the Securities Act generally prohibits sales of unregistered securities unless there is an applicable exemption from registration. When customers seek to sell unregistered securities, SCA performs significant due diligence to determine whether an exemption from registration applies. Rule 144 and Section 4(a)(4) of the Securities Act are two such exemptions. Rule 144 affords the seller of unregistered securities a "safe harbor" from being deemed an "underwriter" when certain objective criteria are met. 17 C.F.R. § 230.144 preliminary note; *Revisions to Rules 144 and 145*, 72 Fed. Reg. 71,546, 71,549 (Dec. 17, 2007). Section 4(a)(4) applies to unsolicited brokers' transactions provided the broker-dealer performed sufficient due diligence. 15 U.S.C. § 77d(a)(4).[2]

As a broker-dealer, SCA maintained written documents that reflected the policies and procedures pertaining to the various aspects of its business. The document upon which FINRA has imposed liability on Mr. DiBlasi and SCA is the firm's general WSPs. The NAC held that those WSPs were not reasonably designed to ensure compliance with Section 5 of the Securities Act because they did not accurately describe SCA's microcap business, and because they did not require a "searching inquiry" into the beneficial owners of the microcap securities that the firm was selling.[3]

With respect to evaluating proposed requests to sell unregistered securities, SCA had a standalone, detailed, and extensive Rule 144 Manual.[4] It is that document, not the general WSPs,

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[2] Rule 144 and Section 4(a)(4) are described in more detail in Petitioners Cruz's and Scottsdale Capital Advisors' Opening Brief.
[3] NAC Decision at 83-87 (FINRA 010913-17).
[4] CX-185 (FINRA 006891).

that constituted SCA's written procedures regarding Rule 144 and Section 5 compliance. Importantly for purposes of this case, Mr. DiBlasi had *no* involvement with Rule 144 Manual.[5] Nor did he have any involvement in the actual deposit due diligence and approval process.[6] The NAC inexplicably ignored those controlling points. The Commission should not make the same mistake.

A. The Rule 144 Manual Was Designed To Ensure Section 5 Compliance

The NAC found that SCA's WSPs were not reasonably designed to ensure compliance with Section 5 because they did not require a searching inquiry into the identity of purported beneficial owners.[7] The NAC followed in the errors of the Hearing Panel and based its findings exclusively on the firm's General WSPs while ignoring the Rule 144 Manual, which is the governing document with regards to Section 5 compliance.

Rule 144 is a safe harbor that permits the sale of unregistered securities if certain objective criteria are satisfied. As it pertains to this case, Rule 144 applies if the seller of unregistered securities is not an affiliate of the issuer[8] and has either (1) held those securities for six months, if

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[5] Tr. 127:11–22 (Day 1) (Cruz) (FINRA 002465); Tr. 563:17–564:2, 584:8–13 (Day 3) (Cruz) (FINRA 002902–03, 002923); Tr. 1813:10–13 (Day 8) (Diekmann) (FINRA 004155); Tr. 1922:13–15, 1927:12–1928:7, 1932:16–19, 1944:20–22, 1946:3–7, 1952:22–1953:2, 1975:25–1977:5, 1977:19–21 (Day 8) (DiBlasi) (FINRA 004264, 004269–70, 004274, 004286, 004288, 004294–95, 004317–19, 004319).

[6] *Id.*

[7] NAC Decision at 86 (FINRA 010916).

[8] An affiliate of an issuer is "a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer." 17 C.F.R. § 230.144(a)(1). Affiliates are subject to special requirements when selling unregistered securities pursuant to Rule 144. *Id.* § 230.144(b)(2), (c)–(i). Owners of at least 10% of an issuer's equity are presumed to be affiliates. J. William Hicks, *Resales of Restricted Securities* (2016 ed.) § 4:38. In addition, for purposes of the meaning of "underwriter," the term "issuer" includes, in addition to the entity issuing the securities, "any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer." 15 U.S.C. § 77b(a)(11).

the issuer is subject to, and has complied with, certain reporting requirements; or (2) held those securities for one year, if the issuer is not subject to those requirements. 17 C.F.R. § 230.144(b)(1), (c)-(d).

The Rule 144 Manual was comprehensive. The Rule 144 Manual and its four appendices provided detailed, step-by-step instructions on how to evaluate each element of Rule 144, including the verification of beneficial owners.[9] Several of the manual's sections specifically addressed determining affiliate status and beneficial ownership, the very issues that the NAC claimed SCA's written policies and procedures did not address.[10]

The thrust of Enforcement's Section 5 claims in this matter stemmed from the allegation that the actual owners of certain of SCA's corporate customers may have used "nominee" officers or directors in order to shield their identity from otherwise publicly available documents. While the Rule 144 Manual may not have used the precise term "nominees," it squarely addressed the issue by emphasizing the need to determine the identity of the individual with the economic interest in the stock, *i.e.*, the beneficial owner.[11] For instance, Sections 1.2.2 and 1.2.3 of SCA's Rule 144 Manual supplied detailed guidance on ascertaining the beneficial ownership of securities, which included reviewing publically available information to make sure that nothing conflicted with the information obtained from the client, and to cross-check the total amount of a security owned or controlled by a client with their other known accounts at the firm.[12] Appendix D included further

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[9] Respondents' Opening Br. at 8–9, 11 (FINRA 010147-48, 50).
[10] Tr. 582:3–595:19 (Day 3) (Cruz) (FINRA 002921–34).
[11] Enforcement has previously suggested that the Rule 144 Manual did not address the risk of nominees because the manual did not contain the word "nominee." Not only does this criticism elevate form over substance, but the critique is ironic give that Regulatory Notice 09-05, supposedly FINRA's definitive guidance on Section 5, does not use the term, either. *See* CX-197 at 1–11 (FINRA 006921–31).
[12] CX-185 at 6–7 (FINRA 006896–97).

direction in the boxes titled "Client Name" and "Dep/Tot. Ownership," which instructed registered representatives to obtain the name of the ultimate beneficial owner of securities and assess his or her total shareholdings.[13] In addition, SCA's AML policies, which Enforcement did not allege were deficient, included a red flag directed specifically at misuse of so-called "nominees."[14]

In addition, SCA also used a beneficial ownership declaration form in connection with stock deposits. The form specifically accounted for the possibility that a company could have nominee officers and directors, demanding an unambiguous declaration that: (1) "Beneficial Owner is the exclusive beneficial owner of the Security"; and (2) "No other person or entity whatsoever has any right, title, or interest, legal equitable, contingent or otherwise, in or to the Security."[15] Answering these questions would pierce through the use of nominees because, by definition, nominees do not have the economic interest in the deposited securities.

FinCEN, the federal government agency tasked with combating money laundering and terrorist financing, subsequently approved of this type of compliance method when it published a final rule endorsing the use of beneficial ownership declarations like those that SCA required and obtained.[16] In permitting customer self-reporting of beneficial ownership, FinCEN cited two considerations: "the customer is generally the best source of this information," and "there is

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[13] CX-186 at 1 (FINRA 006915).

[14] CX-184 at 25 (FINRA 006881) (§ 10.3.2 lists as a red flag evidence that "[t]he customer appears to be acting as an agent for an undisclosed principal, but declines or is reluctant, without legitimate commercial reasons, to provide information or is otherwise evasive regarding that person or entity").

[15] *See, e.g.*, RX-1 at 11 (FINRA 008421).

[16] *Customer Due Diligence Requirements for Financial Institutions*, 81 Fed. Reg. 29,398 (May 11, 2016) (to be codified at 31 C.F.R. pts. 1010, 1020, 1023, 1024, and 1026). The standard certification form appended to the FinCEN rule obligates the natural person opening a new account on behalf of a legal entity to provide certain identification information in a form that concludes with a written and signed affirmation—not under penalty of perjury—that the person completing the application "hereby certif[ies], to the best of [his] knowledge, that the information provided above is complete and correct." *Id.* at 29,454–57.

generally no other source of beneficial ownership information available to covered financial institutions, aside from the legal entity itself."[17] If the use of such a form is good enough to assist the federal government in combatting money laundering and terrorist financing, it should be good enough as an aid in assessing Section 5 compliance.

The expert testimony in this matter further demonstrates the robustness of the Rule 144 Manual. FINRA's expert testified that written procedures should address the issues that determine the availability of an exemption from registration, including the who, what, when, and how at each step.[18] Sections 1.1.3 ("RR Responsibilities"), 1.2 ("Due Diligence Steps – The Checklist"), and 1.3 ("Convertible Debt Securities") of SCA's 144 Manual, and their numerous subsections, did exactly that.[19] For example, Section 1.1.3. outlines various due diligence steps to provide the firm with a reasonable basis to believe that a valid exemption exits for the resale of unregistered stock.[20] These include, among other things, documenting all of the due diligence steps in the Deposited Securities Checklist Form and having the client complete, sign, and date the Deposited Securities Request and Securities Deposit Agreement for each deposit.[21]

Section 1.2 provides an in-depth explanation of SCA's due diligence checklist, which is "specifically tailored to follow the elements required under Rule 144."[22] Section 1.2 provides guidance on how to determine whether an issuer is reporting or non-reporting (Section 1.2.1), step-by-step diligence to determine the number of outstanding shares of a company and *beneficial ownership issues* (Section 1.2.2.1), and how to address correspondent accounts (Section 1.2.2.2).[23]

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[17] *Id.* at 29,407.
[18] CX-324 at 8 (FINRA 008392).
[19] CX-185 at 4–11 (FINRA 006894–6901).
[20] CX-185 at 4 (FINRA 006894).
[21] *Id* at 2 (FINRA 006894); *see, e.g.*, RX-1 at 4-6 (FINRA 008414-16).
[22] *Id.* at 5 (FINRA 006895).
[23] *Id.* at 5-7 (FINRA 006895-97).

Section 1.2.3 addresses affiliate/ control person issues, such as the due diligence steps for verifying affiliate or non-affiliate status, including when there is inadequate public information available (Section 1.2.3.1), when it is necessary to tack a client's holdings with a third-party holder and how to address the third-party holder's affiliate status (Section 1.2.3.2), and the due diligence steps necessary to verify a third-party holder's affiliate status (Section 1.2.3.3).[24] Section 1.2 goes on to explain other important issues, including how to determine if the firm has current information on a particular issuer, the current information required for a Rule 144 exemption, and the related due diligence steps (Sections 1.2.4, 1.2.3.1, and 1.2.3.2); the unavailability of the Rule 144 exemption for shell companies and the due diligence required to determine if an issuer is a shell company (Sections 1.2.5 and 1.2.5.1); the importance of obtaining objective legal opinions from qualified legal counsel, and steps to take to ensure that the opinion is from qualified counsel (Section 1.2.6); and how to properly research a client's background for Rule 144 compliance (Section 1.2.7).[25]

Section 1.3 addresses the specific issue of convertible debt securities, noting that such securities "may be subject to high regulatory scrutiny as an unregistered offering" and providing additional due diligence. As a general practice, when analyzing convertible debt securities for Rule 144 compliance, SCA required a written legal opinion from the client, copies of the underlying transaction documents, presumptively disallowed debt conversions involving 20% or more of the outstanding shares of an issuer, and required documents to verify that the debt is legitimate and not part of a fraudulent scheme to issue unregistered securities.[26]

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[24] *Id.* at 7-8 (FINRA 006897-98).
[25] *Id.* at 8-10 (FINRA 006898-68900).
[26] *Id.* at 10-11 (FINRA 0068900-01).

The four supplements to the Rule 144 Manual—Table A ("Rule 144 Resale Requirements Summary"), Table B ("Independent Verification of Convertible Debt Securities"), Table C ("Required Documents for Certificate Deposits"), and Appendix D ("Completing the Deposited Securities Checklist")—provided further, step-by-step guidance.[27]

Table A distilled the basics of Rule 144 compliance into an easy to use table that listed the requirements for both affiliate and non-affiliate sales, and how those requirements changed both before and after a six-month holding period, and after a one-year holding period.[28] Table B supplemented Section 1.3 of the Rule 144 Manual and provided the specific diligence steps for the verification of convertible securities, which varied depending on the disclosure available regarding the particular security as well as the OTC reporting level of the particular company.[29] Table C supplemented Section 1.1.3, providing an overview of the required documents for different types of security deposits, including both physical certificate deposits and restricted non-affiliate certificates.[30] And Appendix D supplemented Section 1.2's due diligence checklists, providing a summary and explanation of each of the items required by the checklist.[31]

The level of detail in the Rule 144 Manual is irreconcilable with a conclusion that SCA did not have reasonable written policies and procedures with respect to Section 5 compliance. Indeed, Petitioners' expert, FINRA's former General Counsel and Executive Vice President, testified that the detail and specificity in the Rule 144 Manual met or surpassed industry norms.[32] At bottom, the NAC's conclusion that SCA's written policies and procedures did not address the need to

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[27] CX-185 at 21–24 (FINRA 006911–14); CX-186 at 1–2 (FINRA 006915–16).
[28] *Id.* at 21 (FINRA 006911).
[29] *Id.* at 22-23 (FINRA 006912-13).
[30] *Id.* at 24 (FINRA 006914).
[31] CX-186 (FINRA 006916).
[32] Tr. 2414:6–2415:15, Tr. 2419:4–13, 2423:18–25 (Day 11) (Menchel) (FINRA 004811–12, 004816, 004820); *see also* RX-38 at 7–11, 13–14 (FINRA 009239–43, 009245–46).

obtain the identity of the beneficial owners of the deposited securities is demonstrably false. The NAC arrived at this faulty conclusion by analyzing the wrong document, and nowhere in its opinion did the NAC even attempt to justify its refusal to analyze the Rule 144 Manual. In the face of this fundamental error, the NAC's decision cannot stand.

B. Mr. DiBlasi Had No Role in Rule 144 Manual

Perhaps even more troubling than the NAC's refusal to consider the governing document regarding SCA's Section 5 policies is the NAC's wholesale disregard of the uncontroverted evidence that Mr. DiBlasi did not have responsibility for SCA's Rule 144 Manual.[33] Instead, the NAC was singularly focused on a drafting error from SCA's 2013 WSPs, which pre-dated Mr. DiBlasi becoming CCO, that incorrectly identified SCA's CCO as being responsible for the Rule 144 procedures. The NAC refused to acknowledge the mountain of evidence indicating that this was simply a benign inaccuracy.[34] The NAC's approach is nothing more than a backdoor way of holding Mr. DiBlasi liable simply because of his job title. Such reasoning cannot stand.[35]

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[33] Tr. 127:11–22 (Day 1) (Cruz) (FINRA 002465); Tr. 563:17–564:2, 584:8–13 (Day 3) (Cruz) (FINRA 002902–03, 002923); Tr. 1813:10–13 (Day 8) (Diekmann) (FINRA 004155); Tr. 1922:13–15, 1927:12–1928:7, 1932:16–19, 1944:20–22, 1946:3–7, 1952:22–1953:2, 1975:25–1977:5, 1977:19–21 (Day 8) (DiBlasi) (FINRA 004264, 004269–70, 004274, 004286, 004288, 004294–95, 004317–19, 004319).

[34] NAC Decision at 102 (FINRA 010932) (disregarding Petitioner's testimony and focusing on the fact that the "May 2013 WSPs specified that the Firm's CCO, at that time, DiBlasi, was responsible for developing and implementing policies and procedures that provided for the review, approval, and resale of Rule 144 transactions.")

[35] *See, e.g.*, Daniel M. Gallagher, Comm'r, Sec. & Exch. Comm'n, Remarks at FINRA Enforcement Conference (Nov. 7, 2013), available at https://www.sec.gov/News/Speech/Detail/Speech/1370540310199 ("[T]he [SEC] and FINRA should be very cautious about bringing failure-to-supervise cases against chief compliance officers, general counsels, or their subordinates. . . . We should be encouraging these personnel to run towards problems, not away from them, and we should not threaten them with liability for trying to be part of the solution."); *See* Rachel Louise Ensign, *Compliance Officer Probes Stir Alarm Among Their Peers*, Wall. St. J. (Sept. 15, 2014 2:21 PM), http://blogs.wsj.com/riskandcompliance/2014/09/15/compliance-officer-probes-stir-alarm-among-their-peers/ ("'Where [CCOs] are assigned *specific responsibilities* in areas that present

The Relevant Period in this matter is December 1, 2013 to June 30, 2014. Mr. DiBlasi became CCO in October of 2013, just prior to the commencement of the Relevant Period.[36] At that time, the WSPs that were already in effect incorrectly stated in Sections 8.18.2 and 8.18.3 that the CCO was responsible for developing and implementing the firm's Rule 144 procedures.[37] Those particular portions of the general WSPs did not reflect the firm's actual practice, and the evidence showed that Mr. Cruz was responsible for the Rule 144 procedures.[38]

When asked about the 2013 WSP's delegation of responsibility for the Rule 144 procedures, Jay Noiman, the CCO when those WSPs were implemented, acknowledged the error. Mr. Noiman, against whom Enforcement did not file any charges, explained the well understood and practical reality that with respect to Rule 144, he "needed to have an expert or an outside entity provide that type of written supervisory procedures because it extended beyond [his] expertise," and then identified Mr. Cruz as that expert.[39]

Mr. DiBlasi's testimony entirely corroborates Mr. Noiman's explanation.[40] While the general WSPs may have been inaccurate at that time as to who was responsible for drafting the applicable Rule 144 procedures, there was no misunderstanding in the firm as to how that was

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substantial risks to investors, we expect them to fulfill those responsibilities and will hold those CCOs who fall short accountable *consistent with the evidence*,' said Brad Bennett, Finra's executive vice president and chief of enforcement . . . ." (emphasis added)); J. Bradley Bennett, Exec. Vice President of Enf't, FINRA, Remarks from the SIFMA Anti-Money Laundering and Financial Crimes Conference (Apr. 5, 2016), available at https://www.finra.org/newsroom/speeches/040516-remarks-sifma-anti-money-laundering-and-financial-crimes-conference ("In each and every case, it's facts and circumstances analysis of conduct.").

[36] Tr. at 1921:14-16 (FINRA 004263).

[37] CX-179 at 63–64 (FINRA 006551–52).

[38] Tr. 1254:23–1255:14 (FINRA 003594–95); Tr. 1933:15–17, 1947:5–14, 1970:3–19 (FINRA 004275, 004289, 004312).

[39] Tr. 1253:11-1254:1 (FINRA 003593-94).

[40] Tr. 1965:23-1966:8 (FINRA 004307-08).

handled. Mr. DiBlasi testified, "It's very clear with everybody at SCA who is responsible for broker/dealer compliance and who is responsible for [Rule] 144. I don't think there's any mistake about that."[41] And, importantly, as described above, SCA had extensive Rule 144 procedures in place so there was no gap (i.e., nothing had fallen through the cracks).

SCA had realized the technical inaccuracy in its general WSPs prior to Mr. DiBlasi assuming the CCO position. By the time Mr. DiBlasi started in his role, the WSPs were already being revised to accurately reflect the fact that the CCO was not responsible for the Rule 144 policies.[42] Mr. DiBlasi testified that "[t]he WSPs were in the process of being updated when I became the CCO," and that the first draft he saw "had already been changed to reflect that [the person responsible for Rule 144 procedures] wasn't the CCO".[43] Indeed, the next regularly scheduled update to the WSPs, in May 2014, corrected that mistake.[44] Mr. DiBlasi testified that the "May 2014 WSPs were updated to reflect the longstanding practice that the CCO was not responsible for the stock deposit procedures."[45]

Appendix B of both the 2013 and 2014 versions of the WSPs stated that the CCO was to update the WSPs annually.[46] That is what Mr. DiBlasi did. Thus, the logic behind the NAC ruining the career of an individual with a spotless record and a distinguished military career is that he did not take it upon himself to force the firm to issue an unscheduled update to the general WSPs in order to fix the reference to the CCO being responsible for the Rule 144 procedures even

[41] Tr. 1947:10-14 (FINRA 004289).
[42] Tr. 1932:22–1933:2, 1945:8–13, 1969:12–1970:9 (FINRA 004274–75, 004287, 004311–12).
[43] Tr. 1969:14-1970:9 (FINRA 004311-12).
[44] CX-180 at 63–64 (FINRA 006711–12).
[45] Tr. 1933:15-17 (FINRA 004275).
[46] CX-181 at 2 (FINRA 006802); CX-182 at 2 (FINRA 006812).

though there was absolutely no confusion or misunderstanding as to where those responsibilities lied.

At the time the May 2014 WSPs were being drafted, SCA was operated by a Management Committee which had been formed to "serve and carry out the duties of the President of the Firm."[47] SCA adopted this structure in December of 2012 because Mr. Hurry wanted to step away from the day-to-day operations of the business, and SCA utilized this structure until it agreed upon an individual that would assume the role of President. The Management Committee operated as a collective of subject-matter experts—Mr. Cruz in Rule 144 transactions, Mr. Noiman (the then-CCO) in compliance, and Mr. DiBlasi in AML.[48] When the Management Committee was dissolved in 2014, prior to the issuance of the revised WSPs, Mr. Cruz assumed the role of President and, with it, the duties of the General Principal.[49]

The May 2014 WSPs delegated Rule 144 operational responsibility to the General Principal. As the drafting of those revised WSPs began while SCA was still using the Management Committee structure, the document defined the General Principal as the Management Committee. By the time the revised WSPs were officially implemented in May 2014, the Management Committee had been dissolved and Mr. Cruz was functioning as the General Principal. Thus, under the revised WSPs, he was the person designated with responsibility for the specific Rule 144 procedures, a responsibility which he faithfully fulfilled. Every witness who was asked about this

[47] CX-180 at 7 (FINRA 006655).
[48] Tr. 1250:12–18 (Day 5) (Noiman) (FINRA 003590); Tr. 1944:10–17, 1970:10–19, 1972:17–1973:2 (Day 8) (DiBlasi) (FINRA 004286, 004312, 004314–15).
[49] Tr. 76:4–77:12, 79:14–24 (Day 1) (Cruz) (FINRA 002414–15, 002417); Tr. 1249:22–1250:18 (Day 5) (Noiman) (FINRA 003589–90).

topic confirmed this understanding, and there has never been any confusion within the firm as to the delegation of responsibility.[50]

In hindsight, it certainly would have been better had SCA changed the language in the May 2014 general WSPs to reflect the intervening dissolution of the Management Committee. But that sloppy wording does not somehow transform Mr. DiBlasi into having arguably been delegated the responsibilities for the Rule 144 procedures. No documents, witness testimony or logic support such a conclusion.

The NAC further justified its conclusion that Mr. DiBlasi was responsible for the Rule 144 procedures by making a patently incorrect interpretation of Appendix B of the May 2014 WSPs.[51] In relevant part, Appendix B provides that Mr. DiBlasi was required to "[e]stablish, maintain and update, as required, the firm rules and procedures, includes (sic) Appendices A and B." Appendix B does not support the NAC's claim.

While it is true that Mr. DiBlasi was responsible for establishing, maintaining, and updating SCA's general WSPs, there is nothing in Appendix B (or any other document, for that matter) that makes Mr. DiBlasi responsible for the separate Rule 144 Manual.[52] The uniform testimony was that Mr. Cruz drafted the Rule 144 Manual[53] and that Mr. Diekmann was responsible for updating

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[50] Tr. 127:11-22 (Day 1) (Cruz) (FINRA 002465); Tr. 563:17-564:2, 584:8-13 (Day 3) (Cruz) (FINRA 002902-03, 002923); Tr. 1813:10-13 (Day 8) (Diekmann) (FINRA 004155); Tr. 1922:13-15, 1927:12-1928:7, 1932:16-19, 1944:20-22, 1946:3-7, Tr. 1947:5–14 , 1952:22-1953:2, 1975:25-1977:5, 1977:19-21 (Day 8) (DiBlasi) (FINRA 004264, 004269-70, 004274, 004286, 004288, 004289, 004294-95, 004317-19, 004319).

[51] NAC Decision at 85 (FINRA 010915). The "WSPs for Rule 144 transactions" is the Rule 144 Manual.

[52] CX-182 at 2 (FINRA 006812); *see generally* CX-185 (FINRA 006891) (Rule 144 Manual).

[53] Tr. 582:6–23 (FINRA 002921).

it.[54] There is not a valid evidentiary basis to conclude that Mr. DiBlasi was responsible for SCA's Rule 144 Manual.

The root of the problem appears to be that the Hearing Panel justified its conclusion by falsely stating that Mr. Cruz testified that Mr. DiBlasi did, indeed, have that responsibility.[55] The Hearing Panel's statement in that regard is befuddling because when Mr. Cruz was asked that question he specifically said that Henry Diekmann, the head of the Rule 144 review team at the time, was responsible for updating the Rule 144 Manual.[56] Although Petitioners identified that error to the NAC, instead of doing something about it, the NAC simply repeated it as basis for Mr. DiBlasi's liability.

This is another troubling example of the NAC predicating liability in this matter on newly invented legal theories and incorrect facts. The Commission should not condone the ruining of a good man's career with such a cavalier treatment of the law and the evidentiary record.

In concluding that the WSPs did not accurately describe SCA's microcap business, the NAC tried to confuse the reader by equivocating between the *creation* and the *upkeep* of the Rule 144 Manual to conclude that SCA "failed to clarify who was responsible for updating the WSPs and who supervised the Rule 144 review process."[57] But a close review of the relevant documents and corresponding testimony demonstrates that there was no confusion on these points. As described above, the record is clear that Mr. DiBlasi was responsible for updating the general WSPs, which is an *entirely separate document* from the Rule 144 Manual.[58] The record is equally

[54] Tr. 584:1–10 (Day 3) (Cruz) (FINRA 002923).
[55] Hearing Panel Decision at 96 (FINRA 010402).
[56] Tr. 666:15-17 (Day 3) (Cruz) (FINRA 003005)
[57] NAC Decision at 86 (FINRA 010916)
[58] CX-181 at 2 (FINRA 006802); CX-182 at 2 (FINRA 006812).

clear that Mr. Cruz created the Rule 144 Manual,[59] Mr. Diekmann updated it periodically,[60] and Mr. Cruz oversaw the Rule 144 review team.[61]

To find that an individual violated Rule 3010, the Commission "first must find that he had supervisory authority" over the subject matter. *Wedbush Sec., Inc.*, Exchange Act Release No. 78568, 2016 WL 4258143, at *8 (Aug. 12, 2016). And where the evidence establishes that a firm's CCO had no responsibility for supervising certain conduct or implementing specialized supervisory systems, there can be no liability as a matter of law. *Dep't of Enf't v. Mut. Serv. Corp.*, Disciplinary Proceeding No. EAF0400630001, 2008 WL 5875662, at *27 (OHO Dec. 16, 2008); *Dep't of Enf't v. Kernweis*, Disciplinary Proceeding No. C02980024, 2000 WL 33299605, at *17 (OHO Feb. 16, 2000).

The uniform and undisputed testimony confirmed that Mr. was not responsible for the Rule 144 Manual. An inaccurate entry in the 2013 general WSPs that preceded Mr. DiBlasi's tenure as CCO, the NAC's refusal to differentiate between the general WSPs and the Rule 144 Manual, and the NAC's reliance on demonstrably false information cannot be the basis of ruining Mr. DiBlasi's career, as a matter of law or fairness. These significant errors mandate a reversal of the NAC's findings.

1. Mr. DiBlasi's Responsibilities

The only reason Mr. DiBlasi has had to suffer through these appeals is because the Hearing Panel seems to have assumed that he must have been involved in the stock deposit review process

[59] Tr. 582:6–23 (FINRA 002921).
[60] Tr. 666:15-17 (FINRA 003005)
[61] *See, e.g.*, Tr. 689:11-13 (FINRA 003028).

because that was a large component of SCA's business and therefore he would not have had much else to do.[62] That assumption was wrong.

In addition to coordinating the process for updating the general WSPs, Mr. DiBlasi oversaw all of the various regulatory filings for SCA, which included such things as making the necessary and timely revisions to Form BD and Form U4s.[63] He ensured that SCA maintained its business records in accordance with applicable regulations, and he performed the requisite email surveillance.[64] Further, he oversaw the annual testing to verify that the firm had appropriate policies and procedures to safeguard customer funds and securities, maintain books and records, and track changes in customer account information and investment objectives.[65] And after all of this was done, he had to compile a report to verify that the Company could submit its annual CEO certification under Rule 3130.[66]

More importantly, in addition to the above duties, Mr. DiBlasi was also tasked with maintaining the firm's robust AML compliance program.[67] SCA's AML program, helmed by Mr. DiBlasi, played an important role in the firm's integrated approach to Rule 144 compliance, encompassing new accounts, deposit review for AML issues, trading, and wires.[68] The Hearing Officer, however, expressly prohibited the introduction of evidence about AML issues.[69] Thus,

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[62] Hearing Panel Decision at 91-92 (FINRA 010397-98).
[63] Tr. 1976:5-1977:5 (Day 8) (DiBlasi) (FINRA 004318-19).
[64] *Id.*
[65] *Id.*; *See also* Tr. 127:11–22 (Day 1) (Cruz) (FINRA 002465);
[66] Tr. 1975:25–1977:8 (DiBlasi) (FINRA 004317–19).
[67] Tr. 1920:21–24 (Day 8) (DiBlasi) (FINRA 004262); *See also* Tr. 563:17–564:2 (Day 3) (Cruz) (FINRA 002902–03).
[68] *See* Tr. 126:17–127:22, 224:8–18 (Day 1) (Cruz) (FINRA 002464–65, 002562); Tr. 563:13–20, 565:15–21, 614:10–14 (Day 3) (Cruz) (FINRA 002902, 002904, 002953); Tr. 1823:15–18 (Day 8) (Diekmann) (FINRA 004165); Tr. 1920:21–1921:13, 1944:10–14, 1972:17–22 (Day 8) (DiBlasi) (FINRA 004262–63, 004286, 004314).
[69] *See* Tr. of Final Pre-Hearing Conference at 32:6–13, 35:21–36:18 (FINRA 002322, 002325–26); Tr. 1834:9–18 (Day 8) (FINRA 004176).

how Mr. DiBlasi addressed AML issues with respect to stock deposits generally as well as the specific deposits at issue, was off limits. Therefore, Mr. DiBlasi could not address how determinations were made as to whether any of the deposits were suspicious for AML and SAR reporting purposes or whether the deposits posed risks for use of nominees pursuant to the firm's AML policies. It is profoundly unjust to find Mr. DiBlasi liable for a supervisory violation when the relevant evidence regarding his supervisory role was not even permitted to be examined.

V. THE NAC'S SANCTIONS ARE EXCESSIVE

FINRA sanctions cannot be punitive. *McCarthy v. SEC*, 406 F.3d 179, 190 (2d Cir. 2005) The Commission therefore has the authority to vacate or reduce punitive sanctions. *Perpetual Sec., Inc.*, Exchange Act Release No. 56613, 2007 WL 2892696, at *12 (Oct. 4, 2007). If the Commission determines to uphold the findings of liability against Mr. DiBilasi despite all of the aforementioned reasons, the Commission should nevertheless vacate or substantially reduce the sanctions against him because of their punitive effect.

One of the principal considerations in determining sanctions for violations of FINRA Rule 3110 is "[w]hether the deficiencies made it difficult to determine the individual or individuals responsible for specific areas of supervision or compliance."[70] But was there was no such difficulty here. To the extent the NAC perceived any confusion on who was responsible for specific subject areas, it was due to the Hearing Panel falsely stating that Mr. Cruz testified that Mr. DiBlasi was responsible for updating the Rule 144 Manual and the NAC parroting back that narrative despite being specifically informed of its falsity.

[70] FINRA, *Sanction Guidelines* at 107 (2018).

The sanction guidelines call for a maximum fine of $37,000 for deficient WSPs, with up to a one-year suspension in "egregious cases."[71] The $50,000 fine and two-year bar are far in excess of the top end of the range in FINRA's sanctions guidelines. The cruelty of these sanctions is magnified when one considers the faulty factual basis upon which they were levied as well as Mr. DiBlasi's personal circumstances.

The sanctions would have a devastating impact on Mr. DiBlasi. Mr. DiBlasi does not have the financial wherewithal to pay the fine. He and his wife have a special needs child and the associated expenses are extremely high. Indeed, Mr. DiBlasi recently went through a personal bankruptcy.

The Commission should also consider that Mr. DiBlasi has, on multiple occasions, provided helpful information to the Government in connection with investigations of other entities and individuals.

Imposing severe sanctions in excess of the Sanctions Guidelines against somebody who has admirably served the country in the military, has a spotless disciplinary record, and a challenging family and financial situation is not the answer.

VI. CONCLUSION

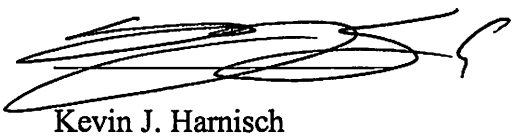
The flaws in the NAC's analysis with respect to Mr. DiBlasi and SCA are numerous and consequential. The NAC's analysis focused on the general WSPs while ignoring the much more detailed Rule 144 Manual. The NAC gave a tortured and illogical interpretation to Appendix B of the WSPs to try to conclude that Mr. DiBlasi was the responsible person for the Rule 144 procedures. And it still could only get to that conclusion by misstating the testimony of Mr. Cruz and ignoring the contrary testimony of every witness that testified on these issues. Consequently,

[71] *Id.*

the Commission should reverse the NAC's finding that Mr. DiBlasi and SCA violated NASD Rule 3010 and FINRA Rule 2010.

Dated: October 5, 2018

Respectfully Submitted,



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ATTORNEY CERTIFICATION

Pursuant to Rule 154(c) of the Commission's Rules of Practice, I hereby certify that foregoing document contains 6,227 words, exclusive of the tables of contents and authorities.

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CERTIFICATE OF SERVICE

I hereby certify that on October 5, 2018, I caused the foregoing to be served by facsimile on the following:

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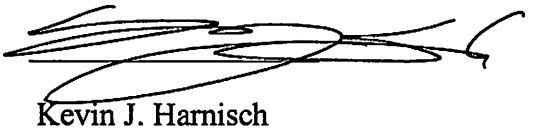

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