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

Paul Eric Flesche's (CRD No. 3277904) Respondent/Appellant

ERIC FLESCHE'S OPENING BRIEF

SEC Case No.: 3-20647

NAC Decision: October 6, 2021

FINRA Decision: April 5, 2019

FINRA Complaint No. 201604956590

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I. THE PURPOSE OF FINRA'S DISCIPLINARY SYSTEM

"The purpose of FINRA's disciplinary process is to protect the investing public, support and improve the overall business standards in the securities industry, and decrease the likelihood of recurrence of misconduct by the disciplined respondent."
https://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf

In reviewing this case, the Commission must consider FINRA's ultimate goal in this matter, protecting the investing public, improving the overall securities business, and decreasing the likelihood of recurrence of misconduct. Once the Commission reviews this current matter through this lens, it can only conclude there was no supervisory violation and the sanctions issued are unwarranted, because the punishment does not affect the investing public, as there were no customer complaints or losses; the sanctions issued against Paul Eric Flesche (Eric Flesche) do not affect the securities business, because, as discussed below, he did everything within his control to achieve his registered agent's compliance with the firm policy and FINRA rules; and, since Huanwei Huang's (Andy Huang) violation of the rules was concealed and it was *impossible* for Eric Flesche to discovery the same without Andy Huang's cooperation; thus, any sanction issued to Eric Flesche on this matter, runs afoul of the purpose for FINRA's disciplinary system.

II. INTRODUCTION

When considering violative conduct, this governing body charged with sanctioning its members must make a finding of: 1. Culpability, i.e. did the offender know of the violative conduct, and/or did the offender *ignore* "red flags" and turn a blind eye to the violative conduct?; 2. The nature of the violative conduct and the damages caused by the violation; and, 3. the supervisor's execution of the firm's WSPs. (*See* Sanctions Guidelines)

Here, in reviewing this case, the Commission has to determine: 1. Eric Flesche's culpability, i.e. did Eric Flesche know, and/or turn a blind eye to the violative conduct? 2. the nature of the underlying violative conduct, and associated damages; and 3. did Eric Flesche execute upon the firm's WSPs? Here, the Commission must find Eric Flesche was not culpable on the failure to supervise charge, because pursuant to the rules, his duty was to execute on the firm's WSPs, and he dutifully executed the WSPs, was unaware of the underlying violative conduct and could not independently become aware of the violative conduct, irrespective of anything within his control; 2. the underlying violative conduct was relatively minor, a books

and records violations with no associated damages (no customers ever complained, no trading losses occurred, and most of the clients involved are still Glendale clients); and 3. Eric Flesche dutifully executed on the firm's WSPs.

III. A REVIEW OF FINRA DISCIPLINARY ACTIONS/STANDARD OF REVIEW

In reviewing FINRA's disciplinary action, the Commission must determine whether Eric Flesche engaged in the conduct FINRA alleged to be violative, whether that conduct violated the statutory provisions or rules specified in OHO/NAC's determination, and whether those provision and rules are, and were applied in a manner, consistent with purpose of the Exchange Act. (15 USC §78s(e)(1)). The Commission must base its finding on an independent review of the record and apply a preponderance of the evidence standard. (*See Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202 at *1, 9 (2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012)

IV. PROCEDURAL HISTORY

Eric Flesche appeals the NAC decision entered on 10.6.21 regarding the sanctions entered against him for an alleged failure to supervise charge for allegedly failing to properly supervise Andy Huang, another registered agent at Glendale Securities, Inc. (Glendale).

A. THE DOE COMPLAINT

On or about 10.5.17, FINRA's Department of Enforcement (DOE), filed a 6-count charge against George Castillo, Eric Flesche, Jose Abadin, Albert Laubenstein, Andy Huang, and Glendale, making the following allegations:

1. Violation of Rule 10b-5 for alleged market manipulation, against George Castillo and Glendale;
2. Violation of §5 for the alleged sale of unregistered securities, against Eric Flesche, Jose Abadin, and Glendale;
3. Inadequate AML procedures against Glendale, George Castillo, Eric Flesche, Al Laubenstein, Andy Huang, and Jose Abadin;
4. Failure to supervise Andy Huang against Glendale, George Castillo, Eric Flesche, and Al Laubenstein (as related to the 6th claim against Andy Huang, for his communications with clients);
5. Violation of Reg S-P against Andy Huang; and,
6. Recordkeeping violations against Andy Huang.

B. THE OHO DECISION

Respondents, participated in an almost 3-week enforcement proceeding in Downtown Los Angeles in July and August 2018 and on 4.5.19, the Office of Hearing Officers (OHO) rendered a 109-page opinion absolving these Respondents of most of the charges.

The OHO opinion dismissed claims: 1 (violation of Rule 10b-5 for alleged market manipulation) as unfounded and not supported by the evidence, and, 2 (violation of §5) finding that the broker's exemption applied in this matter, outright dismissing the charges. The OHO opinion further absolved and dismissed part of the 3rd claim as alleged against George Castillo and Eric Flesche, but found Glendale and Al Laubenstein liable for *some* of the alleged AML violations. OHO also absolved George Castillo on the 4th claim, but found Glendale, Eric Flesche, and Al Laubenstein liable for a failure to supervise Andy Huang, as a result of his unauthorized communication methods with clients. Finally, OHO found Andy Huang liable on the 5th and 6th claims.

On the 4th claim, which is the basis of this appeal, OHO found "that [Eric] Flesche's and [Al] Laubenstein's supervision of [Andy] Huang's communications was unreasonable given the number of Huang's customers, the customer's relationship with KTO and KSC, and the fact that the customers lived overseas." As discussed below, this is OHO's *entire* dissertation discussing the facts and analysis of the law regarding the failure to supervise claim. However, the OHO decision failed to discuss the elements of a failure to supervise claim: 1. did Eric Flesche know of the violation or turn a "blind eye" to the same? 2. the nature of the underlying violation and the associated damages; and, 3. did Eric Flesche dutifully execute on the firm's WSPs?

Nevertheless, OHO censured the firm and fined Glendale and Eric Flesche jointly and severally, $30,000, and suspended Eric Flesche from association with a member firm in all capacities for 30-days. OHO also fined Al Laubenstein $5,000 and suspended him from association in all capacities for 15-days. Al Laubenstein's fine was not joint with the firm.

For the *actual* violation at the center of the failure to supervise claim, the 6th claim, Andy Huang received a $5,000 fine and a 10-day suspension. In short, the wrongful act received a significantly lower sanction than the alleged failure to supervise said wrongful act.

C. ALLEGATIONS OF BIAS AND THE STAY

1. THE STAY

Shortly after the OHO Decision was issued, and during the appeal period, the Chief Hearing Office (CHO) requested a conference call with all of the parties, without informing the Respondents of the subject matter of the call. On the 4.15.19 conference call the CHO indicated allegations of bias were uncovered, and an independent 3rd party law firm would investigate said allegations of bias. The CHO then entered an order to stay all of the proceedings pending the resolution of the "investigation." The CHO refused to respond to any questions involving the alleged bias, where the alleged report of bias originated, or who was allegedly biased, and against whom.

At no time were Respondents made aware of the allegations which led to the "investigation" nor did any third-party law firm contact any of the Respondent's or their attorneys regarding the allegations of bias. Despite repeated demands for information regarding the allegations of bias, Respondents were never made aware of what the allegations were, who the law firm was that was "investigating" the allegations of bias, or what the "results" of the "investigation" were. Instead on 5.2.19, the CHO entered an order lifting the stay, and *resetting* the appeal deadlines, granting DOE an additional 10-days to file their notice of appeal.

Much is made about Respondents' failure to "object" to the stay and "investigation" on the 4.15.19 call. However, without *any* information as to the issues before hand, what the basis of the "investigation" was, or who was being "investigated", and without counsel being able to consult with their respective clients, it was impossible for Respondents to object to the stay in the mere minutes they had between the time the stay was announced until the end of the call, especially since no time was provided to counsel to discuss the issue with their clients. This repeated claim that Respondents did not object is clearly misleading and intended to excuse FINRA and OHO from their covert activities.

The SEC cannot and should not give DOE, OHO, and/or FINRA a pass on this matter. First, as of yet, no one has explained to Respondents what "information" was provided, about whom, by whom, or what the allegations of "bias" were in this matter. It is imperative for Respondents in this matter to know and understand what the allegations of bias were, because it clearly effects their livelihoods.

However, in the absence of any information regarding "bias" a reasonable observant can only assume the reason information is not being released is because there is evidence of bias against Eric Flesche, which would explain the significant sanctions issued against him. One has to wonder if FINRA, DOE, and OHO are biased against these Respondents, because these Respondents, including Eric Flesche were able to demonstrate that DOE was overzealous in prosecuting this case, making baseless allegations, and going as far as doctoring evidencing (see Subsec. 2. below) in order to win-at-all costs.

The OHO process is "supposed" to be unbiased against Respondents, supposed to be. It must be noted that FINRA, DOE, and OHO are conflicted, and often collude with one another in these types of proceedings. For example, OHO hearing officers are FINRA employees, as are DOE prosecutors. Furthermore, OHO is responsible for doling out sanctions against members, which is a substantial portion of FINRA's budget. For example, based on FINRA's own report, FINRA issued $57,000,000 in fines in 2020. This puts FINRA in a very precarious and conflicting position, because they are in effect, prosecutor, judge, jury, and executioner. Furthermore, the more they fine their members, the bigger the benefit to FINRA. In this instance, FINRA is the prosecutor (DOE), the judge and jury, (OHO), the executioner (FINRA), and the ultimate beneficiary of its own acts.

If there was bias in the proceedings, then the Commission *must* compel DOE, OHO, and/or FINRA to turnover to the Respondents in this matter all evidence of said bias, "investigation" and the "results" of the same. How can FINRA claim they uncovered bias, but not inform the affected parties of the nature of the alleged bias, or the result of the "investigation"? This is a clear conflict of interest that requires immediate review by the SEC.

2. DOE MISCONDUCT

In a court of law, if a prosecutor was caught ***tampering*** evidence, they would be disbarred, prosecuted, and jailed. In fact, in a recent article (https://news.yahoo.com/prosecutor-pleads-guilty-resigns-jury-200903608.html), a prosecutor was charged and tried for attempting to tamper with evidence. This prosecutor ultimately "pleaded guilty to four counts in the indictment in exchange for a sentence of five years."

Apparently, OHO does not see evidence tampering by its colleagues in DOE as the serious issue it is, despite DOE being caught with proverbial hand in the cookie jar, when it was discovered, DOE had *manipulated* not 1 but 2 documents, by removing exculpatory information,

then presenting the same as complete to the hearing panel, in a disgusting attempt to punish these Respondents at any cost, even the truth.

DOE presented 2 documents *they* doctored (CX-16 –*doctored* version by DOE; RX-94 – *un-doctored* version by Respondents; CX-109 – *doctored* version by DOE; RX-108 - *un-doctored* version by Respondents). DOE *doctored the documents* and admittedly *removed exculpatory* evidence, without notice to Respondents or the Hearing panel *that they had removed exculpatory evidence*. When Respondents identified the *doctored* documents and pointed out to the same to the hearing panel, instead of dismissing the grossly tainted proceeding altogether and reporting the DOE attorneys to criminal prosecutors for their blatant disregard for the truth and presenting doctored evidence as authentic, the hearing officer still *admitted* the *doctored* documents into evidence, as if doctored documents by DOE are the norm. In fact, when Respondents attempted to have the *un-doctored* document admitted into evidence, DOE objected and attempted to keep the *complete*, *un-doctored* documents from being admitted into evidence. (TT 1324:22-1326:9). Disgusting!

Next, the hearing panel admitted evidence against Respondents, wherein the witness testifying to the authenticity of the documents specifically *admitted* Respondents did not and could not have access to the documents or the information, in real time, or otherwise, *ever*; however, DOE presented the matter as if Respondents were aware of the information contained in said exhibits in real time. (TT 1249:2-1250:10). In this exchange, Mr. Snyder discussed information that he obtained through systems only available to FINRA/DOE, regarding trading in NUGN at other institutions, in an attempt to impugn evil motives behind otherwise honest trades at Glendale, despite knowing Respondents never had access to such trading information at other institutions. Mr. Synder's testimony involved ultimate purchasers of NUGN stock at different brokerage firms, and attempted to impugn knowledge of the identity of these purchasers of stock, to Glendale and George Castillo, in order to evidence market manipulation. However, DOE was fully aware neither George Castillo nor Glendale had access to these resources, and neither George Castillo nor Glendale knew the ultimate purchasers of NUGN stock.

Mr. Snyder's testimony was DOE's attempt to show Glendale colluded with other institutions in order to manipulate the NUGN stock, despite knowing neither George Castillo nor Glendale were privy to any of the said information. Mr. Snyder's testimony was part of the 10b-5 presentation and could have resulted in George Castillo losing his livelihood. Only upon cross-

examination, did Mr. Snyder *admit* the information upon which he was testifying was unavailable to Respondents, thus proving George Castillo and Glendale did *not* collude with other institutions to manipulate the NUGN stock. However, despite the inflammatory, irrelevant, biased, and false nature of the testimony, it was admitted into evidence by the hearing panel.

These are the instances of bias against these Respondents that were discovered and identified in this matter. It is unknown what other misdeeds DOE was involved in, that Respondents did not uncover. Yet, to OHO, this type of behavior is apparently acceptable. Next, the NAC did not even comment on these issues in its opinion affirming the OHO decision.

The Panel demonstrated it was *biased* against Respondents, and yet DOE's case was so baseless, that *despite* the gross bias against Respondents, Respondents prevailed.

3. RESPONDENTS DEMAND ACCESS TO THE INVESTIGATION AND THE ALLEGATIONS OF BIAS. FURTHERMORE, RESPONDENTS DEMAND THE SEC INVESTIGATE THIS CLEAR ABUSE OF POWER AND CONFLICT OF INTEREST BETWEEN OHO, DOE, AND FINRA. FINALLY, RESPONDENTS DEMAND THAT ANY ATTORNEY INVOLVED IN DOCTORING EVIDENCE BE SANCTIONED

D. THE APPEALS

After the CHO terminated the stay on the proceedings, on 5.2.19, DOE appealed the portion of the OHO decision dismissing claims 1 and 2 to the NAC. Thereafter, the NAC requested a review of the 3rd and 4th claims as well.

On 7.15.20, the parties participated in oral arguments before the NAC. And on 10.6.21, the NAC issued a 50-page decision, essentially affirming the OHO decision, with slight modifications to the sanctions.

Both the OHO decision and the NAC decision dedicated very little attention to question of failure to supervise, despite the fact it resulted in one of the largest sanctions in the case ($30,000 fine, and a 30-day suspension in all capacities). The NAC decision provided even less analysis than the OHO decision, yet affirmed the sanctions wielded by OHO, without any analysis of the elements, and despite contrary evidence and logic.

Eric Flesche requests the Commission review the decision with an *unbiased* eye, and asks the Commission to answer these three questions: 1. What exactly did Eric Flesche do wrong to be sanctioned in such a way; 2. What more could Eric Flesche have done to assure an employee's compliance with both FINRA rules and firm rules? 3. Are the sanctions levied really

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commensurate with the alleged wrongful act, or are such heavy sanctions being levied simply to punish Eric Flesche for prevailing on the merits of the other claims?

V. THE ALLEGATIONS, THE FACTS, THE OHO AND NAC DECISIONS

A. THE PERTINENT ALLEGATIONS

The allegations of the failure to supervise can be found in paragraphs 192-204 of the DOE complaint.

The pertinent part of the allegations are: 201. That Eric Flesche failed to supervise Andy Huang's "communications with Firm customers that resided outside of the United States. In particular, [Eric] Flesche was aware that [Andy] Huang opened accounts and conducted securities transactions on behalf of customers in Malaysia and China. However, [Eric] Flesche failed to inquire how [Andy] Huang communicated with his overseas customers in general, or take any reasonable steps to ensure that [Andy] Huang was verifying that his customers understood the communications, including the representations Glendale was seeking from them."

Paragraph 201 is the *sole* remaining allegation on this issue. The other supervisory claims were either dismissed (the §5 claims, ¶¶195-200); and the balance of the claims are against Al Laubenstein (¶202) and Glendale (¶203), neither of whom have appealed the NAC decision.

The allegations in the DOE complaint are key, because FINRA is bound by the terms of their complaint and findings by OHO or the NAC outside of the DOE complaint renders the decision invalid. In fact, the Exchange Act requires FINRA to "bring specific charges," "notify" the respondent of the charges, and give the respondent "an opportunity to defend against" the charges. 15 USC §78o-3(h)(1). Although "a complaint need not specify all details regarding a case against respondent," in order for proceedings to be fair a respondent should "'underst[an]d the issue' and '[be] afforded full opportunity' to justify its conduct during the court of the litigation." *Wanda P. Sears*, Exchange Act Release No. 58075, 2008 WL 2597567, at *3 (July 1, 2008) (quoting *Aloha Airlines, Inc. v. CAB*, 598 F.2d 250, 262 (DC Cir. 1979)). As a result, we have consistently set aside finding of violations based on uncharged theories of liability. *Sears*, *supra*, at *3-4 (setting aside FINRA's finding that applicant made unauthorized trades in certain customers' account because the complaint did not include allegations of unauthorized trades in those accounts and thus respondent "lacked adequate notice" that such trades would be a basis for liability); *Paulson Inv. Co, Inc.*, Exchange Act Release No. 19603, 1983 WL 32198, at *4 (1983).

B. THE OHO DECISION

OHO's decision on the issue of Eric Flesche's alleged failure to supervise can be found in paragraph III.D.3, entitled: "Glendale, Flesche, and Laubenstein failed to supervise Huang in connection with his dealings with his customers." Those 3-full paragraphs are repeated herein:

> The Complaint alleges that the Firm, acting through Flesche and Laubenstein, failed to supervise Huang's communications with his customers in Asia. Even though Flesche knew that Huang opened accounts and engaged in transactions with customers based in Asia. Enforcement alleges, he failed to inquire how Huang communicated with his customers generally or ensure that customers understood the substance of his communications. These included Huang's Chinses language translations of portions of Glendale's new account documents and the VXEL customers' power of attorney.
>
> Laubenstein was responsible for reviewing Huang's emails. The complaint charges that his reviews were limited to periodic English-language word searches of emails contained in the Firm's email archive and he therefore failed to identify red flags of suspicious activity in Huang's emails with customers about VXEL. Enforcement contends that Laubenstein's review was also unreasonable because he took no steps to adopt search terms for Huang's non-English written communications even though he knew that Huang sent customers Chinese-language translations of Firm documents.
>
> The Panel finds that Flesche's and Laubenstein's supervision of Huang's communication was unreasonable given the number of Huang's customers, the customers' relationship with KTO and KSC, and the fact that the customers lived overseas. The Panel finds that Glendale, Flesche, and Laubenstein violated FINRA Rules 3110 and 2010.

That is the *entire* analysis provided on the charge of failing to supervise Andy Huang.

The decision must be overturned for the simple reason that it is a conclusory finding, and does not make a finding on any of the required elements of a failure to supervise claim, but merely concluded the underlying violation of the rules equates to a failure to supervise sanction as well, irrespective of the actual facts of the matter.

In the underlying claim against Andy Huang, which led to the failure to supervise charge, OHO found: "[Andy] Huang engaged in approximately 150 WeChat texts to communicate with KTO and KSC between mid-February and mid-March 2015. [Andy] Huang's use of WeChat instead of the Firm's email system prevented Glendale from being able to capture his communications with KTO in its email archives, causing the Firm's records to be incomplete. The Panel therefore finds that Huang violated FINRA Rules 4511 and 2010." OHO decision at 96.

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In short, OHO concluded Andy Huang violated FINRA rules by using WeChat to communicate with Glendale customers; furthermore, OHO *summarily* concluded Eric Flesche failed to supervise Andy Huang with respect to his communications with KTO and KSC through WeChat. No other instances of a failure to supervise were alleged against Eric Flesche, and OHO did not find any other instances of a failure to supervise.

However, the OHO decision did *not* make any finding of fact regarding Eric Flesche's culpability; the OHO decision did *not* make any finding of fact regarding any alleged damages to the VXEL clients; the OHO decision did *not* make any findings of fact that the Firms' WSPs were inadequate; and the OHO decision did *not* make any findings of fact that Eric Flesche failed to execute upon the firm's WSPs. In short, the OHO decision ignored the elements of charge.

C. THE NAC DECISION

The *entire* analysis provided by the NAC can be found on page 41. The *entire* analysis is as follows:

> Flesche and Laubenstein approved the account opening documents and deposits for Huang's Asia-based customers and Laubenstein was responsible for reviewing Huang's emails. We find that Flesche, Laubenstein, and Glendale failed to reasonably supervise Huang's dealings with these customers. Neither Flesche nor Laubenstein asked Huang about how he communicated with these customers, including whether these customers understood Huang's written communications. While they knew Huang had translated portions of Glendale's account opening documents for these customers, they took no steps to ensure the accuracy of these translations and asked no questions about whether the customers understood the portions of the documents Huang did not translate.
>
> In his review of Huang's email, Laubenstein conducted word searches in English. Laubenstein knew, however, that Huang communicated with these customers in Mandarin and Chinese. His searches were ineffective to identify red flags in Huang's communications with these customers, including Huang's communications with KTO about other customer accounts before Glendale had authorization from those customers to speak with KTO about them.
>
> Accordingly, we find that Glendale, Flesche and Laubenstein failed to reasonably supervise Huang, in violation of FINRA rule 3110 and 2010.

Then in footnote 50, the NAC discusses Andy Huang's violations with respect to KTO and KSC, involving WeChat. No other analysis or factual asserts are discussed by the NAC with respect to the alleged failure to supervise.

Despite OHO providing *zero* factual or legal analysis of what Eric Flesche allegedly did wrong, or why he is being punished or analyze the elements of the charge, the NAC essentially found 2-violations: that Eric Flesche failed to inquire about how Andy Huang was

communicating with overseas customers (i.e the WeChat claims); and 2. that Eric Flesche failed to inquire whether the VXEL shareholders understood the English language on the forms they filled out; however, there is no finding that the VXEL shareholders did not actually speak the English language, or that Respondents' actions were unreasonable in light of the circumstances (i.e. all communication being in English, contracts being signed in English, etc.). In fact, KT Ong, specifically indicate that most of the VXEL Shareholders speak and understand English. "[Panelist Thomas] You had said that some of the shareholders you speak to in English and others you spoke to in Chinese. [KT Ong]: Yes." (TT 2164:12-13) This is especially important because there was no evidence any VXEL shareholders complained they did not understand the communications they had with Andy Huang or the forms they submitted.

However, those fleeting paragraphs are the *only* analysis provided in this matter. Even the NAC decision leaves one wondering what exactly Eric Flesche did wrong (culpability), what he could have done differently, what "damage" did this alleged failure to supervise cause (underlying violation), whether Eric Flesche executed on the firm's WSPs, and does the punishment fit the crime (sanctions)? This is especially true in light of the fact the failure to supervise claim charged that Eric Flesche failed to supervise Andy Huang's communications with KTO and KSC, and the OHO opinion *only* provided a summary conclusion that Eric Flesche failed to supervise Andy Huang's communications with KTO and KSC without any factual support or analysis, which the NAC simply adopted.

VI. THE APPLICABLE RULES

In the complaint, DOE alleged violation of Rule 3110 and 2010.

Rule 2010 is a vague rule that states members "shall observe high standards of commercial honor" when conducting business.

Rule 3110 is a little more complicated, the pertinent subsection requires each member *firm* establish procedures for reviewing "correspondence and internal communications."

Subp. (b) states: "*The supervisory procedures* [i.e. the WSPs] must be appropriate for the member's business, size, structure, and customers. The *supervisory procedures* must require the member's review of: (A) incoming and outgoing written (including electronic) correspondence to properly identify and handle in accordance with firm procedures, customer complaints, instructions, funds, and securities, and communications that are of a subject matter that require review under FINRA rules and federal securities laws. (B) Internal communications to properly

identify those communications that are of a subject matter that require review under FINRA rules and federal securities laws."

Subp. (b) requires the ***firm*** to set up ***procedures*** to monitor member communications. And there is nothing in the records to demonstrate (and neither did OHO and NAC find) any specific defects in the WSP regarding the supervisory procedures. Instead, both OHO and the NAC merely concluded a violation of Rule 2010 and 3110, without any analysis of why or how Glendale or Eric Flesche violated either rule, merely because Andy Huang knowingly violated FINRA and firm communication rules. What about Glendale's WSP are defective? Since neither the OHO decision nor the NAC decision discuss why or how Glendale and/or Eric Flesche violated either Rule 2110 or 3110, this panel must reverse the sanctions against the same.

Although a Rule 3110 violation encompasses a Rule 2010 violation, there is no clear guidance as to whether a Rule 2010 can be used independently for an alleged failure to supervise claim, absent insufficient WSPs pursuant to Rule 3110.

VII. THIS CLAIM SHOULD BE DISMISSED OUTRIGHT

A. RULE 3110 SIMPLY DOES NOT APPLY TO ERIC FLESCHE

Rule 3110 applies *solely* to firms, and there is no indication that Rule 3110 applies to supervisory personnel, in anyway. Specifically, Rule 3110 indicates the *firm* must set up their supervisor procedures to monitor registered individuals' communications.

In fact, even FINRA's own website indicates that Rule 3110 only applies to the *firm's* supervisory procedures, and not the individual supervisor's acts. (https://www.finra.org/rules-guidance/key-topics/supervision). In the opening sentence, FINRA indicates: "FINRA Rule 3110 requires a ***firm*** *to establish and maintain a system to supervise the activities of its associated persons* that is reasonably designed to achieve compliance with the applicable securities laws and regulations and FINRA rules. [¶] The rule details requirements for a *firm* to have reasonably designed written supervisory procedures (WSPs) to supervise the activities of its associated persons …" (Emphasis added).

Furthermore, Regulatory Notice 14-10 (https://www.finra.org/sites/default/files/NoticeDocument/p465940.pdf) specifically states: "FINRA Rule 3110(a) (Supervisory System), based on NASD Rule 3010(a) requires a *firm* to have a supervisory system for the activities of its associated person that is *reasonably* designed to achieve compliance with the applicable securities laws and regulations …."

Legally (and logically), there cannot be a claim against Eric Flesche for a violation of Rule 3110, because Rule 3110 only places duties on the *firm*, not an individual, to establish and execute upon effective WSPs.

As an initial matter, neither OHO, nor the NAC found Glendale's WSPs inadequate in light of the circumstances regarding review of communication pursuant to Rule 3110.

Thus, here Eric Flesche is being sanctioned under a rule that simply does not apply to him; furthermore, even assuming the rule did apply to Eric Flesche, there was no underlying finding of fact the firm's WSPs were inadequate or that Eric Flesche failed to follow the same, or that he turned a blind eye to any violative activity. Since neither the OHO nor the NAC decisions found Glendale's WSPs inadequate in regards to monitoring registered representative communications, nor that Eric Flesche failed to execute on the firm's WSPs, nor that the underlying violative conduct caused any damages, logically there can be no finding of a violation of Rule 3110, even if the rule did apply to Eric Flesche (which it does not). As such, the SEC must dismiss this claim outright, because Rule 3110 simply does not apply to Eric Flesche and it is unclear whether Rule 2010 sanctions are appropriate absent a Rule 3110 violation.

B. UNDER THE RULES, ERIC FLESCHE'S DUTIES ARE TO EXECUTE ON THE FIRM'S WSPs, WHICH HE DID IN THIS CASE.

Even assuming the firm's supervisory WSPs were inadequate for the discovery of noncompliant behavior, Eric Flesche's duties, under the rules, were only to execute on the firm supervisory WSPs, not go beyond the same in order to find potential noncompliant behavior, especially since neither OHO nor the NAC found the firm's WSPs were inadequate. In other words, so long as Eric Flesche did not turn a blind eye to violative conduct and executed on the firm's supervisory WSPs, even if those supervisory WSPs were inadequate (which they were not), the liability would be at the firm level not on the individual level. Thus, Eric Flesche's liability under Rules 2110 and/or 3110 would only exist if Eric Flesche was derelict in the execution of his duties under the supervisory WSPs.

However, what is most troubling is neither the OHO decision nor the NAC decision even discuss the adequacy of Glendale's supervisory WSPs (with respect to the supervisory claims) or the other elements of the charge, but summarily conclude that because Andy Huang communicated with customers using unauthorized methods, that the same equates to a supervisory violation for Eric Flesche, irrespective of the adequacy of the WSPs, or how Eric

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Flesche executed on his duties. However, as articulated above, Rule 3110 requires the *firm* to have *reasonable* supervisory procedures in place, but does not require an individual supervisor, like Eric Flesche, to go beyond the written supervisory WSPs.

Here, Eric Flesche dutifully executed on the firm's WSPs and was *not* derelict in the same. Since Eric Flesche was not derelict in his execution of the firm's WSPs regarding his supervisory roles, it cannot be said he breached his supervisory duties. Since Eric Flesche did not breach his supervisory duties, he cannot be liable under a failure to supervisor theory of liability, even if Andy Huang ultimately violated the rules.

VIII. COMMUNICATIONS WITH CLIENTS

A. THE FIRM WSPs

Did the firm have WSPs related to the supervision of its registered agents? The answer is, of course it did. Exhibit RX-296 lays out the firm WSPs, and firm's WSPs regarding electronic communications can be found on page 7 (¶2.13) and states: "This policy governs the use of electronic communications by personnel of the Firm. This policy also extends to off-hours usage of electronic communications systems." (¶2.13.1). Next paragraph 2.13.4 specifically states: "Electronic communications with customers and/or the public *are permitted only through company-sponsored facilities*."

Next, paragraph 2.13.4.3 specifically indicates: "Newly developed, non-company sponsored electronic communication technologies are *inappropriate* for Firm communications without prior company approval." (Emphasis added)

Furthermore, paragraph 2.13.4.5 specifically indicates: "The firm is required to preserve messages sent and received according to statutory and regulatory requirements. Firm procedures and policies for record retention apply to electronic communications just as do they do for other written communications. The firm uses third party provider Smarsh, Inc. to archive all electronic communications."

Finally, paragraph 2.13.7 lays out the sanctions for employees who fail to comply with the communications WSPs, which includes suspension and termination as possible sanctions.

Clearly the WSPs lay out the rule regarding electronic communications, and specifically indicate that employees are only allowed to use authorized communication methods, and specifically are *not* allowed to use unauthorized communication methods.

It is unknown how much clearer the WSPs could be regarding only the use of authorized communications methods, and the requirement for the preservation of communications.

Neither OHO nor the NAC found the firm's WSPs inadequate.

B. ANDY HUANG'S WECHAT MESSAGES WITH KT ONG AND KS CHIN

Despite being trained on the Firm's WSPs regarding the use of approved communication methods, Andy Huang admittedly broke the rules and communicated with KT Ong, and KS Chin, through WeChat, an unapproved communication device.

1. DID ERIC FLESCHE EXECUTE HIS DUTIES PURSUANT TO THE WSP?

So, the question the SEC has to answer is did Eric Flesche execute the WSPs or was he derelict in his duties? The short answer is Eric Flesche dutifully executed on the WSPs, and was not derelict in his duties, this is because Eric Flesche had trained Andy Huang on the firm WSPs, audited Andy Huang's work on a biannual basis, and Andy Huang certified on an annual basis that he understood only authorized communication methods were acceptable at the firm.

Prior to getting into the analysis of this section, some background information is required. Glendale Securities has two offices, one in Sherman Oaks, California, and the other in Manhattan. (TT 1364:17-18) Most of the Glendale staff are located in the Sherman Oaks office, with Andy Huang being the *sole* agent in the Manhattan office.

As a result of the fact the Manhattan office is approximately 3,000 miles away from the Sherman Oaks office, Glendale established *reasonable* procedures for ensuring Andy Huang was complying with not only FINRA rules, but Glendale's WSP and Glendale policies, especially client communications.

In fact, FINRA Rule 3110 requires a *firm* to establish and maintain a system to supervise the activities of its associated person that is *reasonably* designed to achieve compliance with the applicable securities laws and regulations, and FINRA rules.

For example, on an annual basis, Andy Huang was required to attest that he understands FINRA rules and firm policy on communications with Clients. (RX-318 at 34).

The questionnaire, RX-318 specifically asked Andy Huang to attest that he was aware of and understood FINRA rules and firm polices regarding communications with clients ("Have you reviewed, understood and agree to comply with all current policies and procedures in the firm's Compliance Manual.") *Id* at 34. Andy Huang certified he was aware of and understood FINRA rules and firm polices regarding communications with clients. *Ibid*. Furthermore, the

questionnaire specifically asked Andy Huang to attest that he only used approved communication methods with clients ("I understand that I may use only firm-approved electronic communications systems for communicating with customers"). *Ibid*. Once again, Andy Huang repeatedly attested he understood he could *only use authorized* communication methods with firm clients. *Ibid*. Andy Huang is not a lower-level data entry clerk; Andy Huang is an experienced and licensed registered principal with the knowledge and experience to understand what these representations mean and how important they are in the performance of his duties as the branch manager of the Manhattan office.

Andy Huang *admitted* he was certified on communication methods on an annual basis:

Q: [Speaking on CX-318] Have you reviewed, understand and agree to comply with all current policies and procedures regarding personal securities trading and insider trading activity at our broker-dealer? [¶] You said 'Yes'; right?

[Andy Huang]: Correct.

Q: Move down to number 10. [¶] 'Have you reviewed, understood, and agree to comply with all current policies and procedures in firm's compliance manual?' [¶] is that your check mark by the 'Yes'?

A: Yes.

Q: And number 11, 'Have you reviewed, understood, and agree to comply with all policies regarding personal e-mail accounts? [¶] And you answered 'Yes'; right?

A: Correct.

Q: That's your check mark? [¶] Below number 11, there's another sentence. [¶] 'I understand that I may use only firm-approved electronic communications systems for communicating with customers.' [¶] Is that your check next to the box 'Yes'?

A: Yes, that's correct.

Q: And number 12, have you sent or received any business-related email accounts or account,' and you check 'No' on that one; correct?

A: Correct.

Q: All right. You filled out a questionnaire in 2013 as well; right?

A: Yes.

Q: For the prior year, 2013?

A: Correct.

….

Q: And let's turn to page 42 of this form, RX-318 page 42. Is that your signature next to the description 'Associated Person Signature'?

A: Correct.

Q: And its dated 2/26/14.

A: Correct.

…

Q: And if we go back to exhibit page 36 in RX[318], we see a signature page. And next to the line that says 'Associated Person Signature,' is that your signature?

A: Yes.

Q: As dated 3/11/15; correct?

A: Yes. (TT 1742:11-1746:8)

Next, on a biannual surprise basis, Eric Flesche (them firm CCO), and/or Al Laubenstein (the firm AML Officer) would visit the New York office, to further personally supervise and inspect the Glendale New York offices, and to ensure Andy Huang was complying with both FINRA rules and firm policies. (RX-318)

During those visits, if any violations of FINRA rules or firm policy were observed, corrective measures were taken. Furthermore, during those visits, Andy Huang was verbally asked whether he understood FINRA rules and firm policies, including communicating with clients. (TT 889:7-892:7 pertinent part: "Q: What would you do as part of that audit? [Eric Flesche]: We had a process where we would document the review and would go through several questions. We would generally observe the office an see what kinds of activities were going on, you know, that type of thing. [¶] But it's all a documents process. I think it's a 10- or 15-page process or question where I would ask questions and he would answer, and we would look at those things, and you know, make sure he's got specific signs and make sure no customers are complaining, things like that, because he would have customers in the office at the time."). Andy Huang indicated affirmatively. In fact, in the audit reports (RX-318 at 6) one of the items for review is: "Are all copies of customer correspondence maintained in a central file and maintained for the required three (3) years?" (RX-318 at 6). With "yes" being marked evidencing that Al Laubenstein verified that all customer communications are in systems that are compliant with firm and FINRA rules.

C. ANALYSIS

As identified above, the Rules require *Glendale* have *reasonable* supervisory WSPs in place, "to monitor member communications." Furthermore, the Rules require a member firm review "(A) incoming and outgoing written (including electronic) correspondence" and "(B) Internal communications to properly identify those communication that are of a subject matter that required review" under the rules or the law.

As is evident from the record, Glendale had supervisory systems in place to review and monitor all "incoming and outgoing written (including electronic) correspondence" and "internal communications." However, all Glendale and its COO, Eric Flesche, can do is train their employees to comply with the rules. But, what Glendale and its COO, Eric Flesche, logically

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cannot guarantee is that all of the employees follow the rules set for them, 100% of the time. Much like how a speed limit does not guarantee that drivers will not exceed the same.

So, the question posed to the SEC is as follows: What more could Eric Flesche do to assure that FINRA rules and firm policy regarding communicating with clients were being followed? The reality is, that it is impossible for a supervisor to constantly monitor an employee's activities. If an employee knows the rules, and either intentionally or inadvertently violates the policies, while concealing the violation of the policies, has a supervisor necessarily failed in their supervisory duties? If a registered agent knows certain activity is illegal, but uses off hours and outside sources to conduct said illegal activity, while concealing the same from his supervisor, has the supervisor failed in his supervisory duties, or is the only responsible party, the agent? Obviously, the answer is, the agent is the only responsible party, because he concealed his illegal activities. However, that is exactly what we have here, Andy Huang, used his personal cell phone, to communicate with clients during off-hours, using a communication method, he *knew* was unauthorized and untraceable, while not informing Eric Flesche or Glendale about the same (concealment). Yet, Eric Flesche has been significantly sanctioned for not preventing Andy Huang's covert violation of the rules. A supervisor's role is to train and retrain registered agents to comply with FINRA rules and firm policies, and monitor the same for violations; but the FINRA rules do not require a supervisor ensure a supervisee does not violate FINRA rules or firm policies. Logically, the rules cannot require a supervisor guarantee his supervisee's compliance with the rules, and nowhere in the rules does such a guarantee exist.

Here, Andy Huang was trained and retrained on the policies and procedures of the firm regarding client communications. (RX-296) The WSPs which guide agent activities were provided to Andy Huang. Andy Huang was certified on an annual basis on the use of electronic communications with clients *and verified* he understood the rules regarding only using authorized communication methods with clients. (RX-318). Finally, Andy Huang was the subject of random audits to assure that he was compliant with the rules. ("Q: Okay. It's true, isn't it that you performed audits on Mr. Huang's office with Mr. Laubenstein? [Eric Flesche]: Correct. We switched every couple of years just make sure that one of us wasn't missing something. So we would switch that role every two years. Q: And – A: I would still sometimes go visit New York and see outside of that process, just to make it clear." (TT 890:18-891:2). However, despite his training and retraining on this matter, despite the annual certifications he was complying with

firm and FINRA rules regarding client communications, despite the random site inspections, Andy Huang *still* used WeChat, an unapproved method of communication, to communicate with certain of his customers, in violation of both FINRA rules and firm policies. So, the question must be asked: what else could Glendale and, more specifically, Eric Flesche, do to assure Andy Huang was compliant with firm and FINRA rules regarding client communications?

The above question was asked, to illustrate the point that Eric Flesche, did what was reasonable and within his control to ensure Andy Huang complied with FINRA rules and firm policies. The mere fact Eric Flesche *failed* to actually detect that Andy Huang was using unauthorized communication methods, is not a supervisory shortcoming on Eric Flesche's part, but a willful violation of the rules and concealment of the same on Andy Huang's part. As soon as Eric Flesche was made aware of the use of inappropriate communication methods he reprimanded Andy Huang, appropriately disciplined him with a Letter of Caution (TT 1030:24-1032:9), and asked for printouts of the WeChat communications for the firm's records (Andy Huang had deleted them and WeChat prior to the request) (TT 2568:7-11). Eric Flesche acted swiftly and competently in his supervisory capacity.

Most importantly, neither OHO nor the NAC found Glendale's WSPs inadequate in any regard. Notwithstanding Eric Flesche's reasonable monitoring and review of Andy Huang's understanding and compliance with established firm procedures, Eric Flesche could not, with 100% certainty, ensure Andy Huang was not improperly communicating with clients.

The firm, Glendale, has a duty to create WSPs such that it could monitor and archive employee communications with customers. As is evident from the records, Glendale *had* those WSPs in place. Furthermore, the WSPs were adequate in light of the circumstances. Eric Flesche' duties, as Glendale's CCO, is to execute on the firm WSPs, which he did, by training and retraining Andy Huang on the firm policies and FINRA rules, by obtaining annual verification that Andy Huang understood and complied with firm policies and FINRA rules, and by conducting surprise annual audits, to ensure that Andy Huang was complying with firm policies and FINRA rules. These facts are undisputed. When an agent who is trained on firm policies and FINRA rules, annually certifies he understands firm policy and FINRA rules, and passes biannual surprise audits to assure he complies with firm polices and FINRA rules, fails to abide by his training, it is not a supervisory failure, but a failure of a rogue agent, who knows the rules, but fails to comply with the same.

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In this case, Andy Huang's failure to comply with the firm policies and FINRA rules was not Eric Flesche's shortcoming, but Andy Huang's shortcoming. In this case, there was nothing more Eric Flesche (or Glendale) could have done to assure Andy Huang's compliance with firm policies and FINRA rules. This was not a supervisory failure, but a rogue employee. This is sole logical conclusion the Commission can reach, in light of the overwhelming evidence that Eric Flesche did his job in training Andy Huang; and as such, this Panel must reverse the decision and exonerate Eric Flesche.

IX. ENSURING CLIENTS UNDERSTOOD ANDY HUANG'S COMMUNICATIONS AND TRANSLATIONS OF FIRM DOCUMENTS

A. ARGUMENT

Next, the NAC found Eric Flesche fell short in his supervisory duties when it came to ensuring Glendale clients understand the forms they submit. However, such a conclusion goes beyond the complaint in this matter, that merely alleges that "[Eric] Flesche failed to inquire how [Andy] Huang communicated with his overseas customers in general, or take any reasonable steps to ensure that [Andy] Huang was verifying that his customers understood the communications, including the representations Glendale was seeking from them." (Comp. ¶201). Here, the Complaint did not charge any of the respondents with a violation for FINRA rules for not ensuring that the firm clients understood the forms they were filling. In fact, neither OHO nor the NAC cited any authority, whether from FINRA, the SEC, or any case law, which put the onus on the broker-dealer to ensure a client understood the forms they fill out and submit. In fact, Counsel did an extensive search, in hopes of finding *any* authority requiring a broker-deal to ensure clients understand forms, they filled out and submitted, nothing was discovered. So, the question is asked, what exactly is Eric Flesche's violation here?

In considering this issue, Counsel directs the Commission to consider contract law, because the account applications are tantamount to a contract between the client and Glendale. "[A] party is bound by provisions in an agreement which he signs, even though he has not read them and signs unaware of their existence." *N.A.M.E.S. v. Singer*, 90 Cal.App.3d 653, 656 (1979); *see also George v. Bekins Van & Storage Co.*, 33 Cal.2d 834, 848–49 (1949). Furthermore, "Where a party to a written contract wishes to avoid liability ... on the ground that he did not know its contents, the question, in the absence of misrepresentation, fraud, undue influence, and the like, turns on whether he was guilty of negligence in signing without such

knowledge." *Knox v. Modern Garage & Repair Shop*, 68 Cal.App. 583, 587 (1924). Further, when a party "is negligent in not informing himself of the contents, and signs or accepts the agreement with full opportunity of knowing the true facts, he cannot avoid liability on the ground that he was mistaken concerning such terms." *Id.*; *see also Greve v. Taft Realty Co.*, 101 Cal.App. 343, 351–53, (1929). In fact, this was the approach Glendale took: "[Al Laubenstein]: Well, we presume that if they've signed his document [the account application], they have either read and understood it or they have had someone who could translate it and make them understand it, read it to them. I mean that's basically what you do when you sign a document." (TT 1918: 19-25). "[Eric Flesche]: Again we assume that when somebody is filling out documentation with us, that either the information has been translated to them or that they understand English. So that is an assumption we are making from the standpoint that that is my general understanding of the law in this country of contract and documents." (TT 1006:17-23).

Next, in reviewing the trial transcript, there was no evidence any of the VXEL clients ever complained they did not understand the forms they filled out; there was no evidence any of the VXEL clients ever complained their orders were not properly executed; there was no evidence of any clients seeking compensation from Glendale for any of the trades on their account. In fact, Andy Huang testified that "none of customer complain about anything." (TT 1626:12-23). Actually, most of the VXEL shareholders are still Glendale customers.

Next, in attempting to decipher agreements between the parties, the court often looks to the conduct of the parties involved, did the parties act as if they were party to the contract, and understood the terms of the same. "In construing contract terms, the construction given the contract by the acts and conduct of the parties with knowledge of its terms, and before any controversy arises as to its meaning, is relevant on the issue of the parties' intent." (*Southern Pacific Transportation Co. v. Santa Fe Pacific Pipelines, Inc.* (1999) 74 Cal.App.4th 1232, 1242.) For example, VXEL shareholders reached out to Andy Huang inquiring about how to sell her VXEL shares (CX-68); "[Andy Huang]: Their purpose of open the account, and they try to deposit and sell the stock." (TT 1659:16-1660:2). In fact, other VXEL shareholders also traded on their accounts (TT 1662:6-10). With Andy Huang's testimony that the VXEL shareholder acted as though they understood the documents they filled out and signed, by the process of depositing stock, and selling the same. Thus, at minimum, it is evident the VXEL customers

understood the terms of their account documents, because they acted in accordance with understanding the account documents.

Here, DOE has complained, and OHO and the NAC have sanctioned a rule requiring the broker-dealer to ensure that clients understand the forms they are filling out and signed, despite no such rule existing. Furthermore, both OHO and the NAC ignored that the VXEL clients filled out and signed the account applications; never complained that they did not understand the forms; and, then ultimately acted in accordance with the account documents, by selling the stock they deposited. This coupled with the fact there are no issues of client losses, results in the logical conclusion that VXEL shareholders fully understood the documents they were signing.

B. IT IS IMPOSSIBLE TO ENSURE THAT COMMUNICATIONS ARE UNDERSTOOD

How can Eric Flesche ensure clients understand Andy Huang's communications with clients? How can I (as counsel for Eric Flesche), ensure the person reading this brief understands what I have written? The reality is, I cannot, with 100% certainty, assure that whomever is reading this brief understands the words that I have written. However, the reasonable assumption is that if someone does not understand a document, they will either identify their inability to understand the documents, or they will obtain a way to understand the documents (i.e. have someone read it, translate it, *etc*.) and that is the reasonable assumption Glendale and Eric Flesche made in this instance.

Here, if someone fills out a form, answers the questions asked, provides the required information, signs the underlying document, funds the account, and never identifies their inability to understand the same, then it is reasonably assumed the person understands the document.

However, there is no authority which requires Glendale to *assure* customers understand the forms they are filling out, and none have been identified.

If the rule required an agent *ensure* with 100% certainty their customers understand all communications, then any client who ever lost money on a transaction could claim they simply did not understand their agent and chaos would ensue.

Here, Andy Huang is fluent in several languages, including Chinese, Mandarin, and English. When Andy Huang communicates with clients, Glendale and Eric Flesche may reasonably assume Andy Huang and the client are conversing in a language in which both are

proficient. And logically it has to be reasonably assumed that if a client is responding to Glendale, filling out forms, etc. that they understand the communication language. Thus, Glendale and Eric Flesche must be able to reasonably conclude that if a foreign client completes and signs an application, submits documents, and deposits stock, they either understand the information requested, or requested help in understanding the information requested.

In this case, DOE did not claim the limited translations provided on account application forms were mistranslated, but merely that Eric Flesche did not inquire into the accuracy of the translations. But OHO and the NAC summarily adopted this position, without any factual analysis. In fact, Eric Flesche testified the accounts applications *were* translated into Chinese and the translations *were* independently verified. (TT 2610:3-20)

Next, what damage has this oversight into the accuracy of some transactions caused to clients? No client has ever claimed they did not understand the forms they completed. No client has ever lost any money because they claimed they did not understand forms they completed.

Is such an oversight, worthy of a $30,000 penalty, and a 30-day suspension in all capacities? The simple answer is no, especially in light of the sanctions-considerations outlined in FINRA's Sanction's Guidelines.

X. SANCTIONS CONSIDERATIONS

A. OHO AND THE NAC WRONGFULLY INDICATED THAT ERIC FLESCHE'S CONDUCT WAS EGREGIOUS, WITHOUT ANY ANALYSIS OF WHY OR HOW. OTHER THAN THIS CURRENT CASE, ERIC FLESCHE HAS NEVER HAD ANY DISCIPLINARY ACTIONS AGAINST HIM. THE SANCTIONS MUST REVERSED

Neither OHO nor the NAC followed the Sanctions Guidelines established by FINRA for ensuring compliance with FINRA's rules and regulations.

In determining sanctions for supervision violations, the OHO panel stated they considered "that the Firm has relevant disciplinary history involving similar misconduct, which is an aggravating factor for determining sanctions." (OHO Decision page 91).

OHO erred in its conclusion, because the previous AWC (CX-3) did not have a failure to supervise claim, and therefore, could not be used as an "aggravating factor for determining sanctions." Furthermore, the AWC was against the firm *only*, and did not involve Eric Flesche. Eric Flesche has no disciplinary history, outside of this current matter.

Not only did OHO overreach when trying to relate the AWC with failure to supervise claim, it completely missed the mark when it imposed recidivist status to Eric Flesche individually. That is because Eric Flesche was *not* a party to the underlying AWC, in any capacity. *Id*.

When discussing their sanctions for Cause 4, Supervision of Huang, the OHO Panel properly discussed the guideline standards to be applied:

> "For a failure to supervise, the Guidelines recommend a fine in the range of $5,000 to $77,000, suspending the responsible individual in all supervisory capacities for up to 30 business days, and limiting the activities of the appropriate branch office or department for up to 30 business days. In egregious cases, the Guidelines direct adjudicators to consider limiting the activities of the branch office or department for a longer period or suspending the firm with respect to any or all activities or functions for up to 30 business days." (OHO Decision page 94)

OHO imposed the penalty on Eric Flesche based on the guidelines for egregious cases, but with no allegations, evidence, nor findings supporting such sanctions.

There is no discussion of "egregiousness" of the findings or evidence of recidivist failure to supervise. The Panel's imposition of the suspension on Eric Flesche in all capacities exceeds the Sanction Guidelines and is strictly punitive, may have resulted from the alleged bias, and does nothing to protect the investing public.

On review, the NAC accepted OHO's assessment of the allegations and blindly accepted the sanctions that may be appropriate for an egregious case, without finding any egregious action or recidivist activity by Eric Flesche in connection with his supervisory capacity nor any other capacity. (NAC Decision page 45)

Here, Eric Flesche is not a recidivist, furthermore, as outlined above, Eric Flesche's conduct was appropriate, because he dutifully executed on the firm's WSPs. In fact, the evidence clearly shows Eric Flesche's conduct in this matter was not egregious, but completely reasonable in light of the facts. Nevertheless, even if the Commission affirms the findings of fact that Eric Flesche was responsible for the violation Rule 3110, the panel must modify the NAC's unsupported findings of egregiousness and significantly reduce the sanctions levied.

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B. CASE ID 2016049087201 – LAIDLAW & COMPANY LTD AND JOHN COOLONG

This case is probably the most on-point to our case at bar, although the distinction is that Mr. Coolong *knew* of the violations and turned a "blind eye", and thus was derelict in his supervisory duties, yet Eric Flesche was unaware of the violations, and dutifully executed on the firm's WSPs.

> "During the relevant period, Laidlaw's WSPs provided that electronic business communications could only be accessed and transmitted through firm-sponsored systems. However, during the relevant period, Laidlaw personnel, *including Coolong*, routinely communicated with each other and with customers regarding firm business by text message using their personal mobile phones. *Coolong was aware that individuals he supervised also engaged in this practice*. Laidlaw personnel, including Coolong and the individuals he supervised, did not send these text messages to their supervisors or the firm's compliance department to be reviewed and retained, and the firm did not otherwise retain these business-related electronic communications." (Emphasis added)

In *Laidlaw*, the respondents failed to detect red flags of market manipulation, "Although Laidlaw customers accounted for a substantial percentage of the daily trading volume on numerous days, Laidlaw did not detect—and, therefore, did not review or investigate—multiple occasions when Laidlaw representatives effected cross trades in Company X shares across Laidlaw customer accounts."

Furthermore, in *Laidlaw*, there was a finding that firm's WSPs were "not reasonably designed to achieve compliance with federal securities laws and FINRA rules prohibiting market manipulation."

Thus, in a case that involved *inadequate* firm WSPs, the supervisor's *knowledge* of and participation in the violations (i.e. he was derelict in his duties), *and* market manipulation (cross-trades), Mr. Coolong was suspended 2-months in any principal capacity, and fined $15,000.

C. ALL FAILURE TO SUPERVISE CASES INVOLVED CLIENT LOSSES OR SIGNIFICANT VIOLATION OF THE RULES

In reviewing the recent FINRA failure to supervise claims, all involve a loss to the client, whether trading losses or excessive commissions. Of course, respondent will not cite *every* case, but will highlight the most pertinent and recent decisions on the topic:

Robinhood: In a 6.30.21 release, FINRA sanctioned Robinhood Financial LLC, $57M and ordered restitution of $12.6M "to thousands of harmed customers." Furthermore, FINRA found that "Robinhood failed to reasonably supervise the technology that it relied upon to provide core broker-dealer services, such as accepting and executing customer orders." No suspensions were announced.

Worden Capital: In a 12.31.20 release, FINRA announced that it has sanctioned Worden Capital Management, LLC (WCW) more than $1.5M, including approximately $1.2M in restitution to customers whose accounts were excessively traded by firm representatives. In this case, FINRA found WCW and its owner had "failed to establish and enforce a supervisory system reasonably designed to achieve compliance with FINRA's rules related to excessive trading. In this case, "WCW's registered representatives made unsuitable recommendations to incur more than $1.2M in commissions. After $1.2M in excessive commissions, Worden's owner received a 15-day suspension in all capacities and a 3-month supervisory suspension.

Transamerica: In a 12.21.20 release, FINRA announced that it had sanctioned Transamerica Financial Advisors (TFA) was ordered to pay $4.4M in restitution to approximately 2,400 customers for failing to supervise its registered representatives. No suspensions were announced.

Summit Brokerage. In a 7.2.19 release, FINRA announced it had sanctioned Summit Brokerage Services, Inc. $880,000, including approximately $558,000 in restitution to customers whose accounts were excessively traded by a former registered representative of the firm. FINRA found that Summit "failed to review certain automated trade alerts for its registered representatives' trading activity." For example, the registered agent in question "excessively traded securities in the accounts of 14 customers" wherein he "placed 533 trades for a retired customer over a three-year period, causing her to pay more than $171,000 in commissions." Despite such damage to the clients, no suspension was issued.

D. OUR CURRENT CASE – THE SANCTIONS LEVIED ARE EXCESSIVE IN LIGHT OF THE OTHER CASES

As can be seen, all of the failure to supervise cases cited involve client damage and loss, or a failure to supervise major malfeasance. Some of the most egregious violations, which resulted in significant loss to the client (Robinhood - $12.6M; Transamerica - $4.4M; Summit Brokerage - $558,000) resulted in no suspension. In fact, the two case that resulted in a

suspension, one involved client losses of $1.2M; however, the suspension was only for 15-days, and the other involved a failure to detect market manipulation and resulted in a 2-month suspension in a principal capacity only.

In our current case, there was no excessive client trading or *any* client losses. In fact, the alleged failure to supervise was significantly more benign, a failure to supervise unknown text messages, when there was no reasonable way for Eric Flesche to know about or supervise the same, because Andy Huang concealed the text messages from his supervisor. For such an oversight, Eric Flesche was suspended for 30-days in all capacities, and fined $30,000. By levying such a hefty-sanction against Eric Flesche, the panel has essentially ruled Eric Flesche's failure to supervise Andy Huang's text messages, were twice as bad Worden's $1.2M in client losses, but only half as bad as Laidlaw's knowing involvement in market manipulation, and intentional failure to detect market manipulation, even though Laidlaw was suspended in a principal capacity only, and Eric Flesche is being suspended in all capacities.

The sanctions levied in this matter are simply not in line with other FINRA decisions, nor are the sanctions levied commensurate with the alleged underlying violation.

E. THE SANCTION GUIDELINES

The sanctions guidelines for a failure to supervise claims includes three principal considerations:

1. Whether respondent ignored "red flags" warnings that should have resulted in additional supervisory scrutiny. Consider whether individuals responsible for underlying misconduct attempted to conceal misconduct from respondent.
2. Nature, extent, size, and character of underlying misconduct.
3. Quality and degree of supervisor's implementation of the firm's supervisory procedures and controls.

Then the guidelines provide for a $5,000 to $77,000 fine, and *up to* a 30-business-day suspension.

F. ANALYSIS

Usually, the failure to supervise claim involves misdeeds by a representative to the detriment of their client. For example, in the *Bones* (Case No.: 2017056432604), there was a significant failure of supervision, because Bones allowed his supervisee overtrade in customer accounts, accumulate losses in excess of $400,000, while incurring over $400,000 in commissions, thus a net loss to the clients of over $825,000. Furthermore, Bones was aware of the improper trading, yet refused to prevent the same, significantly damaging clients.

The other informative case is the *Laidlaw* case. In *Laidlaw*, the supervisees were using unauthorized communication methods with clients. However, unlike our case, in *Laidlaw*, the supervisor was *aware* of the improper communications being done, and once again failed to prevent the same. Also, *Laidlaw* involved market manipulation, not a records violation.

1. DID ERIC FLESCHE KNOW OR IGNORE RED FLAGS?

As identified above, Eric Flesche was wholly unaware of the violative conduct, because it is *impossible* for Eric Flesche to ensure a supervisee only uses approved communication methods with clients. Not only was Eric Flesche unaware of the underlying violative conduct, but Andy Huang was aware that short of informing Eric Flesche that he has improperly communicated with clients, Eric Flesche would have never discovered the same. As such, Andy Huang never informed Eric Flesche he was using unauthorized communication methods with clients, until after FINRA visited the Manhattan office and photographed the WeChat messages. In short, Andy Huang was concealing his violation of the rules.

Regarding the issue of ensuring the clients understand the forms, once again, Eric Flesche was wholly unaware of the violative conduct, because there is no such requirement in the rules; furthermore, there were no complaints that any customer did not understand the forms or the documentation they were presenting the firm. Finally, all translations were independently verified as accurate.

As such, the first prong weighs in favor of Eric Flesche and a lighter sanction.

2. THE UNDERLYING VIOLATIVE CONDUCT

The underlying violative conduct was not a severe violation of the rules, and did not result in any customer loss or damage to a client. The underlying violation is a books and records violation, which resulted in a 10-day suspension, and a $5,000 fine for the culprit, Andy Huang. In this case, in light of the facts stated above, the supervisory sanction cannot be more severe than the underlying violative conduct.

The fact the underlying violation is relatively minor, coupled with fact there was no customer loss, the fact Andy Huang concealed the violative conduct, and the other facts in this case, weighs in favor of Eric Flesche, and a lighter sanction.

3. DID ERIC FLESCHE EXECUTE ON THE WSPs?

As identified above, Eric Flesche executed on the firm's WSPs, honoring both their word and spirit. On an annual basis, Eric Flesche certified Andy Huang on proper communication

methods with clients; on a biannual basis, Eric Flesche audited the New York office, to ensure the firm polices were being executed. Next, all of Andy Huang's known communications were monitored. With regard to the claim involving ensuring the clients understand the forms submitted, Appellant has been unable to find any rule, law, guidance, or suggestion that requires a broker-dealer to ensure clients understand the documents fill out and submit to the firm.

Since Eric Flesche dutifully executed on the WSPs, this factor also weighs in favor of Eric Flesche and a lighter sanction.

XI. SUGGESTED SANCTION

Eric Flesche requests that the Commission reverse the NAC's affirmance of the failure to supervise claim and dismiss the claim, for the reasons stated above.

However, if the Commission is not inclined to reverse the NAC's decision and dismiss the charges, then Eric Flesche requests sanctions more in keeping with the guidelines, because the alleged violative conduct, is more academic, in light of the fact no losses were ever reported, was not an egregious violation, and was a first-time violation. In this instance, Eric Flesche followed the firm's WSPs and executed his supervisory duties the firm established for him. Glendale has been fined and has paid the fine. No fine is warranted for Eric Flesche personally. While the actions of Appellant do not warrant a suspension, if the Commission determines it is appropriate, Appellant requests that any suspension be limited to his supervisory capacity *only*.

Respectfully submitted this 7th day of February 2022.

/s/ Arash Shirdel

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CERTIFICATE OF COMPLIANCE

The undersigned hereby certifies that this brief is 28 pages in length, including all headings, but excluding any table of contents and authorities. As such, this brief is shorter in length than the 30 page and is presumed to be shorter than the 14,000 words allowed pursuant to Rule 450.

Dated: 2.7.22

PACIFIC PREMIER LAW GROUP

/s/ Arash Shirdel, Esq.

Arash Shirdel, Esq.

CERTIFICATE OF SERVICE

THE UNDERSIGNED CERTIFIES that on this 7th day of February 2022, a true and correct copy of the foregoing ERIC FLESCHE'S OPENING BRIEF was filed electronically using the Commission's Electronic Filings in Administrative Proceedings (eFAP) system accessed through the Commission's website, upon the following:

Through eFAP

The Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Room 10915
Washington, D.C. 20549-1090

With a copy delivered via electronic mail to:

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