

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 75054 / May 27, 2015

Admin. Proc. File No. 3-15601

In the Matter of the Application of

MITCHELL H. FILLET
Rockville, MD

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION — REVIEW OF DISCIPLINARY
PROCEEDINGS

Material Misstatements and Failure to Disclose Material Information

Conduct Inconsistent with Just and Equitable Principles of Trade

Former general securities representative and principal of member firm appeals from a FINRA action finding that he made material misstatements and failed to disclose material information to an investor in connection with the sale of a security, falsified his firm's books and records, and provided falsified records to FINRA during an examination. *Held*, FINRA's findings of violations are sustained in part and set aside in part and its assessment of sanctions is sustained in part and set aside and remanded in part.

APPEARANCES:

Mitchell F. Fillet, pro se.

Robert L.D. Colby, Alan Lawhead, and Jennifer C. Brooks for the Financial Industry
Regulatory Authority, Inc.

Appeal filed: November 1, 2013
Last brief received: March 31, 2014

Mitchell H. Fillet, former general securities representative and principal of The Riderwood Group Inc. ("Riderwood" or the "Firm"), formerly a FINRA member, appeals from a two-count FINRA disciplinary action. FINRA found that Fillet "made material misrepresentations and omissions in connection with the sale of securities to an investor" in violation of Section 10(b) of the Securities Exchange Act of 1934, Exchange Act Rule 10b-5(b), NASD Conduct Rules 2120 and 2110, and IM-2310-2.¹ FINRA also found that Fillet violated NASD Conduct Rules 3110 and 2110² by falsifying Riderwood customer-related records and providing these falsified records to FINRA during an examination. FINRA imposed a \$10,000 fine and an eighteen-month suspension for the fraud violations and a \$10,000 fine and a two-year suspension for the violations of NASD Rules 3110 and 2110, ordering that Fillet serve the suspensions consecutively.³

On appeal, Fillet primarily challenges FINRA's findings that he made material misstatements and failed to disclose material information in an offering document used to solicit an investor in a private placement offering. Although Fillet admits that he drafted the offering document for his customer's use in the offering in question, he contends that he cannot be held liable for the fraud violations because the document was only a preliminary draft and he did not give the document to the investor. Fillet does not contest FINRA's findings that he falsified various variable annuity records of Firm customers, but he challenges the sanctions imposed for this misconduct.

Following our independent review, we sustain FINRA's findings that Fillet's material misstatements and failures to disclose material information violated NASD Rules 2120 and 2110 and IM-2310-2. We also sustain FINRA's findings that Fillet's failure to disclose material information violated Section 10(b) of the Exchange Act, and Rule 10b-5(a) and (c) thereunder. But we find that FINRA failed to establish that Fillet violated Exchange Act Rule 10b-5(b), and we dismiss these findings of violation. As a result, we set aside the sanctions FINRA imposed for the fraud violations and remand for its reconsideration of these sanctions in light of the

¹ 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5; NASD Conduct Rules 2120 and 2110; and IM-2310-2. Since the time of the alleged misconduct, FINRA has renamed NASD Rules 2120 and 2110 as FINRA Rules 2020 and 2010, respectively, without substantive change, and IM-2310-2 has been subsumed within the supplementary material to FINRA Rule 2110. *Order Approving FINRA's Adoption of Certain FINRA Rules in the Consolidated Rulebook*, 73 Fed. Reg. 57,174 (Oct. 1, 2008). We apply the rules and regulations in effect at the time of the alleged misconduct.

² NASD Conduct Rule 3110; NASD Conduct Rule 2110. NASD Rule 3110 is now FINRA Rule 4511. *Order Approving Proposed Rule Change Adopting FINRA Rules Regarding Books and Records in the Consolidated FINRA Rulebook*, 76 Fed. Reg. 5,850 (Feb. 2, 2011).

³ FINRA also ordered Fillet to pay administrative costs. FINRA's sanctions have been stayed pending Fillet's appeal to the Commission.

dismissed charges. Finally, we sustain the violations for the falsification of Firm records and the sanction FINRA imposed for these violations.⁴

I. BACKGROUND

Fillet, an experienced securities professional, entered the industry in 1972. In 2004, Fillet joined Riderwood, a registered broker-dealer that provided various investment-banking services to its customers, including assistance in private placements, mergers, and acquisitions. In 2007 and 2008, the period relevant to this proceeding, Fillet held an ownership interest in the Firm and was Riderwood's chief executive officer, president, and senior investment banker.⁵

A. Fillet provided private placement services to FAO Sweet Shoppes, Inc., and Catering Acquisition Corp.

FINRA's fraud allegations arise out of Fillet's communications to an investor concerning a private placement offering by FAO Sweet Shoppes, Inc. ("Sweet Shoppes") and Catering Acquisition Corp. ("CAC"), two shell companies run by Allan Sloan ("Sloan"), their principal and founder. Sloan formed Sweet Shoppes to operate a retail café that would sell toys, food, and party facilities in close alignment with and under a "global license" from FAO Schwarz, Inc. ("FAO"), the national toy retailer. Sloan formed CAC to acquire food service companies to produce and supply food for the Sweet Shoppes cafés.⁶

In June 2007, Sloan hired Riderwood to provide CAC with "advisory, investment banking, and placement services" for CAC's "acquisition of a series of food-related enterprises." On behalf of Riderwood, Fillet executed the engagement agreement (the "Engagement Agreement"), agreeing to conduct due diligence, draft transactional documents, identify prospective investors, and act as a placement agent for CAC's securities offering. According to Fillet, CAC paid Riderwood a total of \$20,000 to \$30,000 for its services. Riderwood also had the potential under the Engagement Agreement to earn five percent of the outstanding and voting common shares of CAC within ten days of the closing of any offering and a percentage of the gross proceeds raised in the offering.

⁴ Fillet included in his opening brief a "motion to dismiss the charge of securities fraud" and a "motion to reduce the severity of the sanctions." Fillet's "motion[s]" are arguments against sustaining FINRA's findings of violation and sanctions determination, which we address below. Fillet has also moved to dismiss the proceedings based on the erroneous assumption that FINRA untimely filed its opposition brief on February 28, 2014. FINRA's opposition brief was not due until March 1, 2014, and thus was timely filed. *See Extension Order*, Exchange Act Release No. 71277, 2014 WL 97132, at *1 (Jan. 9, 2014).

⁵ Riderwood withdrew its FINRA membership in February 2009, after which Fillet became associated with another FINRA member until December 2009. Fillet is not currently associated with a FINRA member; the record indicates he is engaging in consulting work.

⁶ Sloan did not testify before the FINRA Hearing Panel.

1. Fillet drafted the Term Sheet for the Sweet Shoppes/CAC offering.

Pursuant to the Engagement Agreement, Fillet drafted various documents for the Sweet Shoppes/CAC offering, including a Confidential Term Sheet (the "Term Sheet").⁷ According to the Term Sheet, the offering totaled \$3,000,000 and consisted of twenty investment units at \$150,000 per unit. Each unit was comprised of an \$80,000 CAC "Series A 10% Corporate Note," a \$70,000 Sweet Shoppes "Series A 10% Corporate Note," and detachable warrants to purchase shares of Sweet Shoppes and CAC common stock. The Term Sheet identified Riderwood as the "sole marketing agent," Fillet as a person to contact for the offering, and Sloan as the CEO for both issuers in the offering.

It is uncontested that the Term Sheet that Fillet drafted contained representations about Sweet Shoppes and CAC that were inaccurate as of the date on the Term Sheet, January 14, 2008. The Term Sheet stated that CAC "was founded in 2007 to create a vertically-integrated, brand name food service company that started in New York City but became national in scope." It also stated that Sweet Shoppes "is closely aligned with FAO" and operates under "a global license from FAO Schwarz and the FAO Family Trust." Fillet conceded in his hearing testimony that, as of January 14, 2008, CAC was neither an operating company with any assets, nor "national in scope," and Sweet Shoppes had not secured "a global license from FAO and FAO Family Trust."

2. Fillet communicated with potential investor PM.

The record shows that at least one person, PM, invested in the Sweet Shoppes/CAC offering. PM testified that he became interested in Sweet Shoppes/CAC through his friend Edward Schmults, then the CEO of FAO.⁸ According to PM, in late 2007, Schmults asked him to speak with Sloan about investing in Sweet Shoppes/CAC, describing Sloan as an "experienced food [services] operator" who would be running Sweet Shoppes for FAO. After PM had several phone conversations with Sloan, Sloan invited him to meet with Fillet.

a. Fillet met with PM to discuss investment in CAC/Sweet Shoppes.

On January 16, 2008 (two days after the date of the Term Sheet), Fillet and Sloan met with PM at PM's office. PM testified that although he had several subsequent telephone conversations with Fillet, this was the only time he met with Fillet in person. PM believed that Sloan arranged the meeting with Fillet because Fillet was an investment banker and would "add credibility to Sloan" and the investment. During the meeting, Fillet discussed the business plans of Sweet Shoppes and CAC, the terms of the offering, PM's qualifications as an accredited investor, and PM's potential investment of \$150,000. PM understood from his discussions with Sloan and Fillet that the Sweet Shoppes/CAC business venture was developing, that CAC was on the verge of acquiring a large catering business, and that "there already was a commissary, going

⁷ In addition to the Term Sheet, Fillet drafted the promissory notes, subscription agreement, and business and investment summary for the offering.

⁸ Schmults did not testify at the hearing.

business, . . . providing the food that would be used in the[] different [Sweet Shoppes stores]." PM testified that he was not given a copy of the Term Sheet at the January 16th meeting.

b. PM received the Term Sheet and invested in CAC/Sweet Shoppes.

The record indicates that PM received the Term Sheet along with other offering documents sometime between January 16 and February 21, 2008. But the record is unclear as to the exact date or the identity of the person who provided the Term Sheet to PM. Fillet has maintained throughout the proceeding that the Term Sheet and other offering documents he drafted were "just drafts," which he gave to Sloan and Sloan's lawyer to review. Fillet testified that he never gave PM the Term Sheet, stating that "I'm not really sure [who gave PM a copy] but it was not from Riderwood" because "[PM] had very little contact with Riderwood." Fillet acknowledged that he later became aware that the Term Sheet had been provided to PM and there is no evidence that he sought to correct any of the statements in it.

PM could not recall who gave him the Term Sheet, testifying that the offering documents "were delivered to my office but I don't . . . remember anybody physically delivering them to me." On February 21, 2008, PM returned a signed subscription agreement to Sloan and gave him a \$150,000 check that was payable to CAC and noted "re notes and warrants" in the memo portion of the check.

3. PM sought reimbursement for his investment after discovering Sloan's criminal history.

In the months after PM's investment, the Sweet Shoppes/CAC business venture unraveled. According to PM, a few months after investing he voiced his concerns about the deal to Sloan, who told him that he could have his money back. PM then spoke with Schmults, who informed PM that FAO recently had terminated its business arrangement with Sloan. When PM asked Schmults why, Schmults told him that he could not say but that PM could "Google Sloan and find out [for himself]." Soon after the conversation, PM had one of his employees conduct a search of Sloan, which found that Sloan had an extensive criminal and civil record and had been disbarred as an attorney.

Public records searches of Sloan (under "Alan Sloan" and aliases "Allen Sloan" and "Allan Gerald Slotnick") show two criminal convictions, disbarment, personal bankruptcy, and eighty-seven tax and judgment liens against him. Sloan was convicted and sentenced to one to three years' imprisonment in 1987 for submitting a false affidavit to a New York court. Shortly thereafter, the State of New York disbarred Sloan based on his 1987 conviction and for converting client funds, issuing bad checks, and refusing to return client funds. Sloan also was convicted in 2003 and sentenced to three to six years' imprisonment for possession of stolen property (a rental car). None of Sloan's legal history was disclosed in the Term Sheet or any other offering document.

At FINRA's hearing, Fillet admitted that he knew about Sloan's 2003 criminal conviction, testifying that he learned about the conviction in late 2007 while conducting his due diligence of CAC. Fillet testified that Sloan thereafter provided him with a letter from Sloan's criminal defense attorney in which the attorney described the stolen property prosecution as "absurd," despite Sloan's conviction. Fillet claimed that he did not disclose the information in the Term Sheet or directly to PM because he had told Sloan to disclose it. Although there is no evidence that Fillet was aware of Sloan's other legal problems during the relevant period, the record demonstrates that the background search of Sloan by Riderwood at the time was flawed. As Fillet concedes, the Firm searched only under the name "*Alan Sloan*" and not under Sloan's other aliases, even though "Allan" was used in the Engagement Agreement and "Allen" was the name listed on Sloan's 2003 conviction.⁹

PM's discovery of Sloan's criminal past prompted him to seek rescission from Sloan and Fillet. According to PM, Sloan agreed to reimburse PM but on three separate occasions gave PM a check that bounced. Fillet disclaimed any responsibility for returning the funds, informing PM that he was only Sloan's agent and reminding him that he had paid Sloan the money. PM testified that, had he known about Sloan's criminal past, he "never would have made this investment." PM never recovered any of his money. He filed a complaint with FINRA, prompting an investigation.

B. Fillet backdated certain firm records and provided those records to FINRA during an examination.

FINRA's second cause of action concerns Fillet's conduct during FINRA's routine examination of Riderwood's main office in Maryland, the underlying facts of which are undisputed. During this examination, a FINRA examiner requested to review Riderwood's variable annuity transactions for suitability. The Firm conducted most of its variable annuity business in its branch offices in Michigan and Indiana, but Fillet supervised these transactions from his office in Maryland. Fillet told the examiner that a branch office completed the relevant forms and then faxed them to Fillet, who would sign and date the documents after completing his supervisory review. Fillet told the examiner that he then returned the forms to the branch offices where the documents were kept.

While the FINRA examiner waited in a Riderwood conference room for the Firm to produce the variable annuity transaction documents for review, he discovered documents arriving by fax from Riderwood's branch offices. The documents included customer-account forms, applications, and acknowledgment forms related to ten variable annuity transactions for seven Riderwood customers. They lacked Fillet's supervisory signatures. Fillet, meanwhile, was unaware of the examiner's discovery. About an hour later, according to the examiner, Fillet handed these same documents to the examiner, but only after Fillet had signed and dated them as

⁹ The letter from Sloan's criminal defense attorney, which Fillet reviewed, also used the name "Allen" Sloan.

though he had reviewed them near the time the Indiana branch office had completed them.¹⁰ Suspecting that Fillet had backdated the documents, the examiner requested that the Indiana branch office resend the documents and, when it did, the documents contained none of Fillet's signatures.

Thereafter, FINRA staff conducted an examination of Riderwood's Indiana branch office and obtained copies of the documents that had been transmitted during the examination. None of the documents contained Fillet's signatures.

In his correspondence with FINRA and during his on-the-record ("OTR") testimony, Fillet denied FINRA's charges that he had backdated the documents.¹¹ But at the hearing, after the FINRA examiner involved testified, Fillet admitted that he had signed and dated the relevant documents during the examination. As Fillet conceded, "[H]ad I personally had any inkling that this was such a big deal . . . , I would not have done what I did."

C. FINRA found that Fillet violated the Exchange Act's antifraud provisions and FINRA rules and imposed sanctions.

After a one-day hearing, a FINRA Hearing Panel found Fillet liable on both counts charged in FINRA's complaint: (i) that Fillet made material misrepresentations and misleading omissions in connection with his sale of securities by CAC and Sweet Shoppes in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, NASD Rules 2120 and 2110, and IM-2310-2; and (ii) that Fillet falsified Firm records and submitted these false records to FINRA during an examination in violation of NASD Rules 3110 and 2110. The Hearing Panel suspended Fillet for six months and fined him \$10,000 for the fraud violations and suspended him for two years and fined him \$10,000 for violating NASD Rules 3110 and 2110.

On appeal, FINRA's National Adjudicatory Council ("NAC") affirmed the Hearing Panel's findings that Fillet violated Exchange Act Section 10(b), Exchange Act Rule 10b-5, NASD Rules 2120 and 2110, and IM-2310-2 by drafting the misleading Term Sheet and failing to disclose Sloan's criminal past. But the NAC modified the Hearing Panel's sanctions for these violations by increasing the suspension from six to eighteen months, while sustaining the \$10,000 fine for these violations. The NAC also sustained the findings of violations and sanctions imposed for Fillet's violations of NASD Rules 3110 and 2110. This appeal followed.

¹⁰ Fillet signed and dated the documents as far back as December 2007, often using a date that was approximately one week after the registered representative signed the document.

¹¹ Fillet stated in his OTR testimony, dated February 20, 2009, "To the best of my knowledge, I never backdated a file during the whole time I was at Riderwood." He also gave various excuses for the discrepancies in the documents sent by the branch office and those he supplied to FINRA, including that the documents "got lost in the mail."

II. ANALYSIS

A. Standard of Review

Pursuant to Section 19(e) of the Exchange Act, in reviewing a FINRA disciplinary action, we determine whether the member or associated person engaged in the conduct found by FINRA, whether the conduct violated the securities laws or rules found by FINRA, and whether those rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.¹² In conducting our *de novo* review, we apply a preponderance of evidence standard to determine whether the record supports FINRA's findings.¹³

B. Fillet's violations of FINRA's antifraud provisions.

NASD Conduct Rule 2120, FINRA's antifraud rule, prohibits FINRA members and their associated persons from effecting "any transaction in, or induc[ing] the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." NASD Conduct Rule 2110 requires adherence to "high standards of commercial honor and just and equitable principles of trade." Moreover, IM 2310-2 imposes on members and registered representatives the "fundamental responsibility for fair dealing,' which is '[i]mplicit in all [their] relationships' with customers."¹⁴ IM 2310-2 identifies several activities that "clearly violate" this responsibility, including "non-disclosure or misstatement of material facts."¹⁵

FINRA found that Fillet violated NASD Rules 2120 and 2110 and IM-2310-2 by drafting the Term Sheet for the Sweet Shoppes/CAC offering that "contained inaccurate information" and by "fail[ing] to disclose to an investor the criminal history of [Sloan, who was] instrumental to the offering." As FINRA found, Fillet had a "duty not to mislead [PM] in connection with the CAC and Sweet Shoppes offering," which he violated when he, "acting with scienter, induced

¹² 15 U.S.C. § 78s(e); *see, e.g., Joseph Abbondante*, Exchange Act Release No. 53066, 2006 WL 42393, at *6 (Jan. 6, 2006), *petition denied*, 209 Fed. App'x 6 (2d Cir. 2006). The rules at issue are consistent with the Exchange Act. *See, e.g., Scott Epstein*, Exchange Act Release No. 59328, 2009 WL 223611, at *12 (Jan. 30, 2009) (applying IM-2310-2 in sustaining FINRA action); *Nat'l Assoc. Sec. Dealers, Inc.*, Exchange Act Release No. 2211, 1939 WL 36389, at *3 (Aug. 7, 1939) (approving prior versions of NASD's Rules 2110 and 2120); *Adoption of Exchange Act Rule 10b-5*, Exchange Act Release No. 3230, 1942 WL 34443, at *1 (May 21, 1942) (adopting Rule 10b-5 by authority granted under Exchange Act Section 10(b));.

¹³ *Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *9 (May 27, 2011) (citing *Seaton v. SEC*, 670 F.2d 309, 311 (D.C. Cir. 1982) (upholding preponderance of evidence standard in FINRA (then NASD) disciplinary proceeding)), *aff'd*, 693 F.3d 251 (1st Cir. 2012). Fillet claims a different standard of proof applies, citing *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007). But *Tellabs* involved "the pleading requirements" for "private securities fraud actions," not FINRA disciplinary actions.

¹⁴ *Epstein*, 2009 WL 223611, at *12 (quoting NASD Rule IM 2310-2).

¹⁵ NASD Rule IM 2310-2.

[PM's] purchase of a security by means of fraud and deception." Based on our review of the record, we agree with FINRA and conclude, as set forth below, that Fillet violated NASD Rules 2120 and 2110 and IM-2310-2.

1. **Fillet violated FINRA Rules 2120 and 2110, and IM-2310-2 by inducing PM's purchase by means of false statements.**
 - a. **The Sweet Shoppes/CAC private placement involved the sale of a security.**

We find that the Sweet Shoppes/CAC private placement offering involved the sale of a security. Both Section 2(a)(1) of the Securities Act of 1933 and Section 3(a)(10) of the Exchange Act define a "security" to include "any . . . warrant" to purchase stock.¹⁶ The Term Sheet and subscription agreement to the offering made clear that, upon investing in the enterprise, investors would receive "detachable warrants" to purchase Sweet Shoppes/CAC common stock at a fixed price in the future.¹⁷

Fillet contends that PM's payment to Sloan was merely a "loan" and not a securities investment. But, other than his self-serving testimony, there is no basis for this finding. The Term Sheet he drafted described the offering as "a high risk transaction [that] can only be purchased by an accredited investor as defined under the Securities Act." And the subscription agreement, which he also drafted, required PM's acknowledgement that the units being sold were "restricted securities under the 1933 Act." Further, Fillet does not dispute that PM paid Sloan the price for one unit in the offering (\$150,000) or that PM gave Sloan a check that stated that payment was for "notes and warrants."¹⁸ We thus find the preponderance of evidence establishes that the transaction involved the sale of a security.

- b. **The misstatements in the Term Sheet were material.**

Fillet does not dispute that the Term Sheet that he drafted contained misstatements of fact. The Term Sheet stated that CAC was a "food service company that started in New York City but became national in scope," that "Sweet Shoppes is closely aligned with FAO," and that

¹⁶ 15 U.S.C. §§ 77b, 78c(a)(10); *see also Kusner v. First Pa. Corp.*, 531 F.2d 1234, 1237 (3d Cir. 1976) ("[T]he warrants here . . . are securities within the meaning of both the Securities Act and Securities Exchange Act."); *Investors Funding Corp. Sec. Litig.*, 523 F. Supp. 550, 556 n.3 (S.D.N.Y. 1980) ("[W]arrants are no less securities than common stock[.]").

¹⁷ FINRA did not address whether the offering's notes were also securities, but notes generally are presumed to be securities, 15 U.S.C. §§ 77b, 78c(a)(10), and the notes here appear to meet the test articulated in *Reves v. Ernst & Young*, 494 U.S. 56, 67-68 (1990) (finding that unsecured demand notes issued by a farmers' co-op to raise capital were securities).

¹⁸ The subscription agreement in the record lacks Sloan's signature, but the preponderance of the evidence, including PM's testimony and his cashed check, establish that the transaction took place as contemplated by the document.

Sweet Shoppes "operates under a global license from [FAO] and the FAO Family Trust." But none of this was true. As Fillet concedes, CAC was neither an operating company nor "national in scope." It was a shell company with no assets or operations. And Sweet Shoppes was merely a concept that never secured a licensing agreement from FAO.

We find that these misstatements were material. A fact is material if there is a substantial likelihood that a reasonable investor would have viewed it as significantly altering the total mix of information made available.¹⁹ A reasonable investor would want to know that CAC, formed for the purpose of acquiring a series of food companies for producing Sweet Shoppes' food, was nothing more than a shell,²⁰ and that Sweet Shoppes, which based its business model on aligning itself with FAO, did not have a licensing agreement with FAO.²¹ The licensing agreement was particularly critical to Sweet Shoppes' success, as evidenced by the demise of the business shortly after FAO terminated its licensing negotiations.²² PM's testimony further supports our conclusion; he testified that the main reason he invested in the offering was because he believed that these misstatements were true. As a result, we find Fillet's misstatements "significantly altered the 'total mix' of information available to the investor."²³

¹⁹ *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

²⁰ *See, e.g., Shores v. Sklar*, 647 F.2d 462, 466 (5th Cir. 1981) (deeming a misrepresentation of assets to be materially false and misleading); *Elipas v. Jedynek*, No. 07 C 3026, 2010 WL 1611024, at *2 (N.D. Ill. Apr. 20, 2010) (finding a representation that plaintiffs were investing directly in the company when they were actually purchasing equity on a secondary market was a material misrepresentation); *SEC v. Lauer*, No. 03-80612-CIV, 2008 WL 4372896, at *20 (S.D. Fla. Sept. 24, 2008) (finding it material that investors did not know their investments were actually in shell companies).

²¹ *See, e.g., SEC v. Reys*, 712 F. Supp. 2d 1170, 1176-77 (W.D. Wash. 2010) (finding a failure to disclose the company's inability to obtain a specially formulated compound, which was essential to the company's business, to be material); *Peritus Software Servs., Inc. Sec. Litig.*, 52 F. Supp. 2d 211, 222 (D. Mass. 1999) (finding company's recognition of revenue on fictitious licenses was a material misrepresentation); *Kevin M. Glodek*, Exchange Act Release No. 60937, 2009 WL 3652429, at *5 (Nov. 4, 2009) (finding representations about issuer's imminent listing on stock exchange when issuer had not filed necessary listing application was material), *petition denied*, 416 F. App'x 95 (2d Cir. 2011).

²² *Cf. United States v. Reyes*, 577 F.3d 1069, 1076 (9th Cir. 2009) (holding that the materiality of an issuer's "financial condition, solvency, and profitability is not subject to serious challenge" (quoting *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980))).

²³ *Matrixx Initiatives, Inc v. Siracusano*, 131 S. Ct. 1309, 1312 (2011) (quoting *Basic Inc.*, 485 U.S. at 231-32).

c. Fillet acted with scienter.

We also find, as FINRA did, that Fillet acted with scienter, "a mental state embracing intent to deceive, manipulate, or defraud."²⁴ Scienter may be established by recklessness, defined as "an extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the [actor] or is so obvious that the actor must have been aware of it."²⁵ Fillet admitted that he knew when he drafted the Term Sheet that the business descriptions about Sweet Shoppes and CAC were inaccurate, but he included these facts anyway.

Fillet claims, as he testified at the hearing, that the statements in the Term Sheet were inaccurate because they were subject to contingencies—in particular, CAC's acquisition of food service companies and Sweet Shoppes' securing a licensing agreement from FAO—that had not yet occurred but that he assumed would occur before investments were made. He also claims that he provided only a preliminary "draft" of the Term Sheet to Sloan and did not intend for investors to receive it. But FINRA's Hearing Panel "did not find [this testimony] credible." We generally accord considerable weight and deference to the fact finder's credibility determination and see no reason to depart from that determination here.²⁶ Nothing on the face of the Term Sheet suggested it was only a draft. And Fillet has produced no evidence, documentary or otherwise, to substantiate his testimony.²⁷

Even if we accept Fillet's explanation as true, we find that he acted at least recklessly when he drafted and provided an offering document to Sloan that he knew contained inaccurate statements without taking adequate precautions against its possible dissemination to investors. Although Fillet was Riderwood's senior investment banker and had almost forty years' experience, he took no steps to prevent a potential investor from being misled if the document were to be released. For example, while he claims that the statements at issue were meant to be contingent on certain events occurring, he failed to use any cautionary language alerting a potential reader to contingencies. Nor did he take the basic step of identifying the document as a "draft." Even when Fillet later learned that PM had received a copy of the Term Sheet, he did nothing to correct the misstatements. These failures were an extreme departure from the standards of ordinary care expected of brokers.²⁸

²⁴ *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

²⁵ *Dolphin & Bradbury v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008) (quoting *SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992)).

²⁶ *See, e.g., Rita J. McConville*, Exchange Act Release No. 51950, 2005 WL 1560276, at *6 n. 21 (June 30, 2005) (observing that "the credibility determination of an initial fact finder is entitled to considerable weight and deference because it is based on hearing the witnesses' testimony and observing their demeanor"), *petition denied*, 465 F.3d 780 (7th Cir. 2006).

²⁷ At the hearing, Fillet admittedly could not produce a cover letter or e-mail stating that the Term Sheet was merely a draft. He also called no witnesses that could substantiate his claim.

²⁸ *See e.g., Robert Tretiak*, Exchange Act Release No. 47534, 2003 WL 1339182, at *7 (Mar. 19, 2003) (finding that president of member firm was at least reckless in failing to ensure

d. Fillet induced PM's purchase of securities.

Fillet also asserts that he never gave the Term Sheet to PM, suggesting he cannot be liable because he did not "make" the misstatements in the Term Sheet. We disagree. Unlike Exchange Act Rule 10b-5(b), which prohibits "mak[ing] any untrue statement of material fact,"²⁹ NASD Rule 2120 "does not require a [person] to 'make' a statement in order to be liable"³⁰ and thus it is not "so restricted."³¹ Rather, the express language of NASD Rule 2120 turns on whether Fillet "induce[d] the purchase . . . [of] any security by means of any manipulative, deceptive or other fraudulent device or contrivance." Therefore, even if Fillet did not "make" the statements in the Term Sheet within the meaning of Rule 10b-5(b), Fillet drafted an offering document containing material misstatements that induced PM to invest. Thus, we find that, at a minimum, Fillet recklessly induced PM to purchase Sweet Shoppes and CAC securities by means of a "manipulative, deceptive, or other fraudulent device or contrivance," namely the Term Sheet, in violation of NASD Rule 2120.³²

For all these reasons, we find that Fillet's misconduct in drafting false and misleading statements in an offering document violated NASD Rule 2120 and thereby Rule 2110.³³ Fillet also violated IM 2310-2's fair dealing requirement by failing to ensure that PM was not misled by the offering document Fillet drafted. Accordingly, we sustain FINRA's findings of violation with respect to these provisions.

(...continued)

that the prospectus he drafted accurately reflected information critical to the offering). Fillet's claim that he drafted the Term Sheet for Sloan or his attorney to review and finalize does not mitigate his culpability for drafting the deceptive device.

²⁹ 17 C.F.R. § 240.10b-5(a); *Janus Capital Grp. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011) (interpreting the term "make" under Exchange Act Rule 10b-5(b)).

³⁰ *Cf. SEC v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014) (distinguishing Securities Act Section 17(a) and Exchange Act Rule 10b-5(a) and (c) from Rule 10b-5(b) by the absence of the operative term "make" and finding no such requirement in the aforementioned provisions).

³¹ *Cf. Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 152-53 (1972) (discussing three subsections of Exchange Act Rule 10b-5).

³² *Cf. Monterosso*, 756 F.3d at 1334 (finding that president's and vice president's "commission of deceptive acts as part of a scheme to generate fictitious revenue" violated Exchange Act Section 10(b), Rule 10b-5(a) and (c), and Securities Act Section 17(a)).

³³ A violation of another NASD rule, such as Rule 2120, constitutes a violation of Rule 2110. *CMG Institutional Trading, LLC*, Exchange Act Release No. 59325, 2009 WL 223617, at *8 n.36 (Jan. 30, 2009)).

2. Fillet violated FINRA's antifraud provisions when he failed to disclose material information to PM.

Fillet's failure to disclose Sloan's criminal history to PM also violated NASD Rules 2120 and 2110, and IM-2310-2. The duty of fair dealing under IM-2310-2 requires securities professionals to "not merely avoid affirmative misstatements . . . [but] also [to] disclose 'material adverse facts.'"³⁴ Fillet admits that he first became aware of Sloan's 2003 conviction in late 2007 but never disclosed the information to PM in any of his communications with him.³⁵ This information was unquestionably material because it reflected on the character and integrity of a person integral to the success or failure of the enterprise.³⁶ A reasonable investor would have wanted to know that Sloan, the CEO and founder of both issuers, had been convicted of a felony in 2003 and served prison time.³⁷ PM's testimony—*i.e.*, that, had he known about Sloan's criminal history, he never would have invested in the offering—also supports this conclusion. It is also undisputed that FAO terminated its business relationship with Sloan as soon as it discovered his criminal past, further underscoring the importance of the information to investors.

We agree with FINRA's finding that Fillet acted with scienter in failing to disclose material information. Despite learning of Sloan's conviction for possession of stolen property before the offering commenced, he failed to disclose the information to PM at their January 16th meeting, in his telephone conversations with him, or in the Term Sheet. Fillet knew, or was at

³⁴ *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 WL 1892137, at *6-7 (June 29, 2007) (finding that representatives who made unfounded claims about the merits of an investment without disclosing the poor financial condition of the companies violated federal and NASD antifraud provisions including IM-2310-2); *see also Richard H. Morrow*, Exchange Act Release No. 40392, 1998 WL 556560, at *6 (Sept. 2, 1998); *Richard J. Buck & Co.*, Exchange Act Release No. 8482, 1968 WL 86080, at *6 (Dec. 31, 1968) ("[A] salesman must not merely avoid affirmative misstatements when he recommends the stock to a customer; he must also disclose material adverse facts of which is or should be aware."), *aff'd sub. nom., Hanly v. SEC*, 415 F.2d 589 (2d Cir. 1969)); NASD Rule IM 2310-2, *supra* note 15.

³⁵ *See, e.g., Stern v. Grossman*, Fed. L. Rep. 95,482, 1990 WL 128883, at *2 (S.D.N.Y. Sept. 4 1990) (failure to disclose CEO's prior imprisonment for securities fraud in private placement memorandum); *Stylex Homes Inc.*, Exchange Act Release No. 36299, 1995 WL 579505, at *2 (Sept. 29, 1995) (failure to disclose criminal background of a director in private placement memorandum) (settled proceeding).

³⁶ *See United States v. Hatfield*, 724 F. Supp. 2d 321, 328 (E.D.N.Y. 2010) ("It is well-settled that information impugning management's integrity is material to shareholders.").

³⁷ *See, e.g., SEC v. Elecs. Warehouse, Inc.*, 689 F. Supp. 53, 66 (D. Conn. 1988) ("An indictment for mail fraud of the president and founder of the issuing corporation was a fact that any reasonable investor would have considered important in making the decision to invest in [the issuer]."), *aff'd sub nom., SEC v. Calvo*, 891 F.2d 457 (2d Cir. 1989).

least reckless in not knowing, that he was withholding material information.³⁸ Fillet also had a financial incentive to withhold the information. As the Engagement Agreement provided, Fillet, through Riderwood, would earn a stock grant and percentage of the gross proceeds based on the success of the offering. Withholding damaging information about the issuers' CEO increased the likelihood that PM and others would invest in the offering and thereby Fillet's total compensation. That Fillet stood to gain financially from his fraudulent conduct reinforces our finding that he acted with scienter.³⁹

Our finding that Fillet violated FINRA's antifraud provisions is further supported by his unreasonable failure to discover and disclose the full extent of Sloan's criminal and civil history. FINRA has reminded its members and associated persons of their long-standing obligation "to conduct a reasonable investigation of the issuer and the securities they recommend in [private placement] offerings."⁴⁰ In recommending the purchase or sale of a security, securities professionals represent "that a reasonable investigation has been made and that [their] recommendation rests on the conclusions based on such investigation."⁴¹ Fillet's and Riderwood's due diligence with respect to Sloan, consisting of an internet search that misspelled Sloan's name as "Alan Sloan" even though materials in Fillet's possession showed the correct, current spelling and other aliases, was not reasonable.⁴² The discovery of Sloan's 2003 criminal conviction, alone, should have alerted Fillet of the need to conduct a more probing inquiry into

³⁸ See *Breard v. Sachnoff & Weaver, Ltd.*, 941 F.2d 142, 144 (2d Cir. 1991) ("[F]ailure to mention [the principal seller's] conviction in the initial offering memorandum could be considered reckless as a matter of law.").

³⁹ See, e.g., *Guy P. Riordan*, Exchange Act Release No. 61153, 2009 WL 4731397, at *9 (Dec. 11, 2009) (finding that pecuniary motive for committing violations further establishes respondent's scienter), *petition denied*, 627 F.3d 1230 (D.C. Cir. 2010). Although Fillet claims he ceased marketing Sweet Shoppes/CAC in February 2008, he does not dispute, and the Engagement Agreement confirms, that he was acting as Sloan's agent during the times he communicated with PM.

⁴⁰ FINRA Notice 10-22, *Obligation of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings*, 2010 WL 1625161, at *2 (Apr. 22, 2010) ("FINRA Notice 10-22") ("The [Commission] and federal courts have long held that a [broker-dealer] that recommends a security is under a duty to conduct a reasonable investigation concerning that security and the issuer's representations about it." (internal quotation marks omitted) (citing *SEC v. N. Am. Research and Dev. Corp.*, 424 F.2d 63, 84 (2d Cir. 1970); *Hanly v. SEC*, 415 F.2d 589, 595-96 (2d Cir. 1969); *SEC v. Current Fin. Servs., Inc.*, 100 F. Supp. 2d 1, 7 (D.D.C. 2000); and *Everest Sec., Inc.*, Exchange Act Release No. 37600, 52 SEC 958, 1996 WL 487682, at *4-5 (Aug. 26, 1996), *aff'd in part and vacated in part on other grounds*, 116 F. 3d 1235 (8th Cir. 1997))).

⁴¹ FINRA Notice 10-22, 2010 WL 1625161, at *2 (quoting *Hanly*, 415 F.2d at 597).

⁴² The Engagement Agreement and Sloan's 2003 criminal conviction (and Sloan's attorney's explanation of it) reflected the names Allan Sloan and Allen Sloan, respectively.

Sloan's background.⁴³ Instead, Fillet relied on Sloan and his attorney for information regarding his past misconduct. Had Fillet conducted a public records search using the correct spelling of his name or aliases, he would have learned that Sloan had an extensive legal history, including another felony conviction and disbarment as an attorney, a recent bankruptcy filing, and hundreds of thousands of dollars in civil judgments and liens against him, all of which we find would have been material to investors.⁴⁴

Fillet contends that Sloan was the person responsible for disclosing his legal history. But we have long held that a securities professional "has a responsibility for his own or her own actions and cannot blame others for [his or her] own failings."⁴⁵ Fillet, as discussed, had a duty to speak truthfully and completely about the transaction with PM, which included "disclos[ing] material adverse facts of which he is or should be aware."⁴⁶ By withholding material information from PM with scienter, Fillet induced PM's purchase of a security by means of a "manipulative, deceptive, or fraudulent" device or contrivance in violation of NASD Rules 2120 and 2110, and IM-2310-2. Accordingly, we sustain FINRA's findings in this regard.

C. Fillet's violations of Exchange Act Section 10(b) and Rule 10b-5.

FINRA also found that Fillet's misconduct violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Section 10(b) makes it unlawful for any person "to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe."⁴⁷ Rule 10b-5 implements the Commission's authority under Section 10(b) through three subsections: Rule 10b-5(a) prohibits "directly or indirectly . . . employ[ing] any device, scheme, or artifice to defraud;"⁴⁸ Rule 10b-5(b) prohibits "directly or indirectly . . . mak[ing] any untrue statement of a material fact or [omitting] to state a material fact necessary in order to make the statements made . . . not misleading;"⁴⁹ and Rule 10b-5(c) prohibits "directly or indirectly . . .

⁴³ Cf. FINRA Notice 10-22, 2010 WL 1625161, at *3 ("[T]he presence of any 'red flags' also would alert the broker to the need for further inquiry." (citing *Univ. Hill Found. v. Goldman Sachs & Co.*, 422 F. Supp. 879, 898 (S.D.N.Y. 1976))).

⁴⁴ See, e.g., *SEC v. Merchant Capital, LLC*, 483 F.3d 747, 770-71 (11th Cir. 2007) (finding failures to disclose management's financial problems, including personal bankruptcy, and previous cease-and-desist order, were material).

⁴⁵ *Philip L. Spartis*, Exchange Act Release No. 64489, 2011 WL 1825026, at *9 (May 13, 2011) (quoting *Justine Susan Fischer*, Exchange Act Release No. 40335, 1998 WL 484111, at *5 n.4 (Aug. 19, 1998)).

⁴⁶ *Hanly*, 415 F.2d at 592 (quoting *Richard J. Buck & Co.*, Exchange Act Release No. 86080, 1968 WL 86080, at *7-8 (Dec. 31, 1968)).

⁴⁷ 15 U.S.C. § 78j(b).

⁴⁸ 17 C.F.R. § 240.10b-5(a).

⁴⁹ *Id.* § 240.10b-5(b).

engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."⁵⁰ Liability under these subsections requires a showing of scienter.⁵¹

1. Fillet's failure to disclose material information violated Exchange Act Section 10(b) and Rule 10b-5(a) and (c).

For all the reasons stated above with respect to FINRA's antifraud rule, we sustain FINRA's findings that Fillet's failure to disclose Sloan's criminal past violated Exchange Act Section 10(b) and Rule 10b-5.⁵² Fillet, acting with scienter, failed to disclose material information in connection with a securities offering that he recommended to PM.⁵³ When he recommended the investment, Fillet had a duty as a securities professional "to speak truthfully about material issues."⁵⁴ But as found above, he deprived PM of material information necessary to make an informed investment decision, and created a false impression of fact regarding the offering, in violation of his "special duty of fair dealing" with investors.⁵⁵ Accordingly, we find that by failing to disclose Sloan's criminal past, Fillet violated Exchange Act Section 10(b) and Rule 10b-5. Specifically, Fillet's failure to disclose was a deceptive "device, scheme, or artifice to defraud" under Rule 10b-5(a) and a deceptive act that operated as a fraud on the customer under Rule 10b-5(c).⁵⁶

⁵⁰ *Id.* § 240.10b-5(c).

⁵¹ *Hochfelder*, 425 U.S. at 194.

⁵² Fillet's telephone calls with PM alone meet the jurisdictional requirement of Section 10(b). *See, e.g., Loveridge v. Dreagoux*, 678 F.2d 870, 874 (10th Cir. 1982) (holding that interstate telephone calls are sufficient for jurisdiction under antifraud provisions).

⁵³ The Supreme Court has broadly interpreted the "in connection with" phrase of Section 10(b). *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (explaining that "the statute should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes" (internal quotation marks omitted)).

⁵⁴ *Ciaola v. Citibank, N.A., New York*, 295 F.3d 312, 331 (2d Cir. 2002) (stating that broker-dealer, by "cho[osing] to discuss its hedging strategy, . . . had a duty to be both accurate and complete" about the strategy).

⁵⁵ *Cf. SEC v. Hasho*, 784 F. Supp. 1059, 1107 (S.D.N.Y. 1992) (citing *Hanly*, 415 F.2d at 597 ("By making a recommendation, a securities dealer implicitly represents to a buyer of securities that he has an adequate basis for the recommendation.")); *Steven D. Goodman*, Exchange Act Release No. 43889, 2001 WL 62607, at *4 (Jan. 26, 2001) (same).

⁵⁶ *Cf. Monterosso*, 756 F.3d at 1333. We note that FINRA found liability for Fillet's failures to disclose under Rule 10b-5 without specifying a subsection. We find that under these facts, Fillet's failure to disclose violated Rule 10b-5(a) and (c), distinguishing this conduct from the misstatements that FINRA analyzed under Rule 10b-5(b).

2. FINRA has not established that Fillet violated Rule 10b-5(b).

On this record, we are unable to sustain FINRA's finding that Fillet violated Exchange Act Rule 10b-5(b) by making the misrepresentations in the Term Sheet or by making oral misrepresentations to PM.⁵⁷ In *Janus Capital Group v. First Derivative Traders*,⁵⁸ the United States Supreme Court interpreted Rule 10b-5(b)'s prohibition against "mak[ing] any untrue statement of a material fact."⁵⁹ The Court held that an investment adviser who drafted misstatements that were later included in a separate mutual fund's prospectus did not "make" the statements for purposes of Rule 10b-5(b) because the mutual fund itself filed the prospectus.⁶⁰ The Court reasoned that one who merely "prepares" a statement is not its "maker," just as a mere speechwriter lacks "ultimate authority" over the contents of a speech.⁶¹ As a result, the Court concluded that it was the mutual fund, not the mutual fund's adviser, who had "ultimate authority over the statement, including its content and whether and how to communicate it."⁶²

Relying on *Janus*, FINRA concluded that Fillet had ultimate authority "over the content of the statements" because Fillet drafted the Term Sheet and was listed as the contact person on the document. But FINRA failed to address to what extent Fillet had "ultimate authority over . . . whether and how to communicate [the misstatements]."⁶³ Although we strongly reject Fillet's argument that he cannot be liable under Rule 10b-5(b) solely because he was not the person who provided the Term Sheet to PM, there is insufficient evidence of the communications between Fillet and Sloan, Sloan and PM, and PM and Fillet, to determine who had "ultimate authority" over the communication of the misstatements, and therefore who "made" those misstatements.⁶⁴

⁵⁷ 17 C.F.R. § 240.10b-5(b) (making it unlawful for "any person" in connection with the purchase or sale of securities to "directly or indirectly, . . . make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading").

⁵⁸ 131 S. Ct. 2296 (2011).

⁵⁹ *Id.* at 2301.

⁶⁰ *Id.* at 2305.

⁶¹ *Id.* at 2302.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ We agree with FINRA that Fillet and Riderwood were listed prominently in the Term Sheet as the sole and exclusive marketing agent of the offering and that Fillet and a managing director of Riderwood were the only contact persons listed for the offering. These facts suggest that the misstatements in the Term Sheet could be attributable to Fillet. But the evidence also shows that Fillet did not direct or control Sloan's communications with investors. To the contrary, Sloan was president and CEO of CAC and Sweet Shoppes and orchestrated the fraudulent conduct. Without more evidence concerning the communications between Fillet, Sloan, and the investor, we cannot sustain a finding that Fillet had ultimate authority over whether and how the Term Sheet was communicated to investors. *See, e.g., SEC v. Pentagon Capital Mgmt.*, 725 F.3d 279, 285-86 (2d Cir. 2013) (affirming liability under Rule 10b-5(b) for

Therefore, under the applicable preponderance of evidence standard, we have determined that the record does not support a finding that Fillet violated Exchange Act Rule 10b-5(b) by making the misrepresentations in the Term Sheet.

FINRA also found that Fillet violated Rule 10b-5 because he made oral misrepresentations to PM during their meeting that were similar to the misrepresentations in the Term Sheet. But, based on our de novo review of the record, PM's testimony during the hearing did not establish by a preponderance of the evidence that Fillet made these oral representations to PM. Rather, PM could not recall who had made the oral misrepresentations. As a result, we have determined that the record does not support a finding that Fillet violated Exchange Act Rule 10b-5 by making such oral misrepresentations.

C. Fillet violated NASD Rules 3110 and 2110 by backdating customer-related documents and providing those materials to FINRA during an examination.

As to FINRA's second cause of action, NASD Conduct Rule 3110(a) required FINRA members to "make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder, with FINRA's Rules, and as prescribed by Exchange Act Rule 17a-3."⁶⁵ The recordkeeping rules "include[] the requirement that the records be accurate, which applies 'regardless of whether the information itself is mandated.'"⁶⁶ NASD Rule 115 made NASD's rules, including these requirements, applicable in equal force to "[FINRA] members and persons associated with a member," such as Fillet.⁶⁷ Proof of scienter is not required.⁶⁸

Fillet does not dispute that he violated NASD Rule 3110 by backdating customer-account records and providing those documents to FINRA, and we find that sufficient evidence supports sustaining these violations.⁶⁹ The documents were records Riderwood was required to maintain, including customer-account forms, applications, and acknowledgment forms related to variable-

(...continued)

late-trading scheme where defendants retained "ultimate authority" over misrepresentations when they directed brokers to communicate trade sheets containing misleading time-stamps), *cert. denied*, 2014 WL 2921728 (U.S. June 30, 2014).

⁶⁵ NASD Rule 3110(a); *see also* 17 C.F.R. § 240.17a-3.

⁶⁶ *Brown*, 2012 WL 625874 at *11 (quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Exchange Act Release No. 33367, 1993 WL 538899 at *7 (Dec. 22, 1993)).

⁶⁷ NASD Rule 0115; *see also* *Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 WL 6044123, at *16 (Nov. 15, 2013).

⁶⁸ *Joseph G. Chiulli*, Exchange Act Release No. 42359, 2000 WL 91733, at *4 (Jan. 28, 2000) ("[NASD] Rule 3110 has no scienter requirement.").

⁶⁹ Fillet acknowledges his prior admission to these charges in his reply brief on appeal, noting "[he] admitted that he was wrong" and he contests only the sanction imposed.

annuity transactions that Riderwood executed for seven of its customers.⁷⁰ Fillet was responsible for conducting a supervisory review of these transactions. He intentionally backdated the documents to give the false impression he had conducted his supervisory review of the transactions closer to the time that the transactions had been executed. By knowingly falsifying customer-related records, Fillet caused Riderwood's books and records to be inaccurate in violation of NASD Rule 3110.⁷¹

Fillet also concedes that he violated NASD Rule 2110 by backdating customer-account records. We have held that providing misleading and inaccurate information to FINRA is conduct contrary to high standards of commercial honor and is inconsistent with just and equitable principles of trade.⁷² "[A] violation of Rule 2110 does not require any showing of scienter."⁷³ In any event, as a principal of a registered broker-dealer with nearly forty years' securities experience, Fillet knew not to mislead regulatory authorities during an examination. In attempting to deceive FINRA with documents he deliberately falsified, Fillet acted unethically in violation of NASD Rule 2110.⁷⁴

Accordingly, for the reasons stated above, we find that Fillet engaged in the conduct found by FINRA, that his conduct violated Rule 2110, and that Rule 2110 is, and was applied in a manner, consistent with the purposes of the Exchange Act.

⁷⁰ See 17 C.F.R. § 240.17a-3(17)(i)(A) and (D) (requiring brokers-dealers to make and keep current certain books and records, including, for each account with a natural person as a customer, "[a]n account record [including various personal information, such as] annual income, net worth . . . and the account's investment objectives" and those for which a "suitability determination" was conducted).

⁷¹ *Brokaw*, 2013 WL 6044123, at *15-16; *Charles E. Kautz*, Exchange Act Release No. 37072, 1996 WL 164181, at *3 (Apr. 5, 1996) ("[I]t is a violation of [FINRA] Rules to enter false information on official firm records.").

⁷² *Brian L. Gibbons*, Exchange Act Release No. 37170, 1996 WL 254664, at *3 (May 8, 1996); see also *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006) (finding bribery, backdating, and altering documents violates "the Rule 2110 requirement that the person's conduct conform to high standards of commercial honor and just and equitable principles of trade").

⁷³ *Kirlin Sec., Inc.*, Exchange Act Release No. 61135, 2009 WL 4731652 at *14 n.87 (Dec. 10, 2009).

⁷⁴ See *Rooms*, 444 F.3d at 1214; *Gen. Bond & Share Co. v. SEC*, 39 F.3d 1451, 1460 (10th Cir. 1994) ("[A]ny reasonable person would know that . . . intentional deception of [FINRA] while it is engaged in an investigation violates the prohibition against conduct contrary to high standards of commercial honor and just and equitable principles of trade.").

III. Sanctions

Pursuant to Exchange Act Section 19(e)(2), we will sustain FINRA's sanction unless we find, having due regard for the public interest and the protection of investors, that the sanction is excessive or oppressive or imposes an unnecessary or inappropriate burden on competition.⁷⁵ As part of this review, we consider any aggravating or mitigating factors and whether the sanctions imposed are remedial and not punitive.⁷⁶ Though not bound by FINRA's Sanction Guidelines, we use them as a benchmark for our review under Exchange Act Section 19(e)(2).⁷⁷

A. FINRA's sanctions imposed for the fraud violations are remanded.

We find it appropriate to set aside and remand FINRA's imposition of sanctions for Fillet's fraud violations. FINRA aggregated its sanction for these violations, imposing an eighteen-month suspension and \$10,000 fine. Because we are setting aside a portion of the fraud violations, we remand the sanctions for these violations to FINRA for reconsideration in light of this dismissal. We do not suggest any view as to the outcome of that reconsideration.

B. FINRA's two-year suspension and \$10,000 fine for Fillet's books-and-records violations are not excessive or oppressive.

For his violations of NASD Rules 3110 and 2110, FINRA suspended Fillet in all capacities for two years and fined him \$10,000. We sustain FINRA's sanctions because they are neither excessive nor oppressive and are in the public interest and for the protection of investors.

For violations of NASD Rule 3110, FINRA's Sanction Guidelines recommend a fine between \$1,000 and \$10,000 and a suspension of the responsible individual for up to thirty business days and, in egregious cases, a fine between \$10,000 and \$100,000 and a suspension for up to two years, or a bar.⁷⁸ For falsification of records in violation of NASD Rule 2110, the Guidelines recommend a fine between \$5,000 to \$100,000 and suspension of the responsible individual for up to two years and, in egregious cases, a bar.⁷⁹ The sanctions imposed are within these recommended ranges.

We agree with FINRA that Fillet's misconduct in backdating records and providing falsified records to FINRA was egregious. We have repeatedly emphasized that the

⁷⁵ 15 U.S.C. § 78s(e)(2). Fillet does not claim, nor does the record show, that FINRA's action imposed an unnecessary or inappropriate burden on competition.

⁷⁶ *Gregory Evan Goldstein*, Exchange Act Release No. 71970, 2014 WL 1494527, at *10 (Apr. 17, 2014).

⁷⁷ *Capwest Sec., Inc.*, Exchange Act Release No. 71340, 2014 WL 198188, at *9 (Jan. 17, 2014).

⁷⁸ FINRA Sanction Guidelines, available at <http://www.finra.org/sites/default/files/Industry/p011038.pdf> at 29 ("Sanction Guidelines").

⁷⁹ *Id.* at 37.

recordkeeping requirements are fundamental to the regulation of the securities industry, serving as the "keystone of our surveillance of brokers and dealers."⁸⁰ The documents at issue consisted of important customer-account records related to the sale of variable annuities. Due to the complex nature of variable annuities, both Commission staff and FINRA have identified these products as particularly vulnerable to questionable sales practices and abuse, requiring broker-dealers to "provid[e] adequate supervision over salespersons, ensur[e] that adequate disclosure is made to customers, and maintain[] all required books and records" with respect to these securities.⁸¹ Fillet signed and backdated documents to cover up his failure to supervise variable annuity transactions at one of Riderwood's branch offices.⁸² His misconduct involved multiple acts of wrongdoing involving ten sets of documents for seven Riderwood customers, undermining the accuracy of the Firm's records for which Fillet was responsible.

Fillet compounded this misconduct by intentionally providing falsified documents to FINRA in an attempt to mislead a FINRA examiner, misconduct that we find aggravating. We have stated that providing truthful information to regulatory authorities is a fundamental obligation of securities professionals.⁸³ And we consistently have held that "deliberate deception of regulatory authorities justifies the severest of sanctions."⁸⁴ Fillet contends he "did not lie to FINRA." But there is no question that his falsification of dates in the customer records at issue constituted intentional misrepresentations to FINRA.

⁸⁰ *vFinance Invest. Inc.*, Exchange Act Release 62448, 2010 WL 2674858, at *8 (July 2, 2010) (alteration omitted).

⁸¹ Joint SEC and NASD Staff Report on Broker-Dealer Sales of Variable Insurance Products (June 2004), available at <http://www.sec.gov/news/studies/secnasdvip.pdf> (noting the importance of broker-dealers' "providing adequate supervision over salespersons, ensuring that adequate disclosure is made to customers, and maintaining all required books and records").

⁸² "Assuring proper supervision is a critical component of broker-dealer operations." *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 WL 32121, at *11 (Jan. 6, 2012) (quoting *Ronald Pelligrino*, Exchange Act Release 59125, 2008 WL 5328765, at *10 (Dec. 19, 2008)), *petition denied*, 739 F.3d 1243 (9th Cir. 2014). FINRA has reminded members of their "obligation to monitor representatives in small, remote branch offices, who may find it easier 'to carry out and conceal violations of the securities laws[.]'" *vFinance*, 2010 WL 2674858, at *2 (quoting NASD Notice to Members 03-33 (July 2003)).

⁸³ *E.g.*, *Peter J. Kisch*, Exchange Act Release No. 19005, 1982 WL 529109, at *6 n.23 (Aug. 24, 1982) ("[D]eception practiced on regulatory authorities . . . is clearly an aggravating factor to be considered in assessing appropriate sanctions."); *see also Brogan v. United States*, 522 U.S. 398, 402 (1998) ("[S]ince it is the very *purpose* of an investigation to uncover the truth, any falsehood relating to the subject of the investigation perverts that function."), *cited in Gary M. Kornman*, Advisers Act Release No. 2840, 2009 WL 367635, at *9 n.42 (Feb. 13, 2009) (barring broker and investment adviser in a follow-on proceeding for making false statements to Commission staff during an investigation), *petition denied*, 592 F.3d 173 (D.C. Cir. 2010).

⁸⁴ *Kornman*, 2009 WL 367635, at *7 (collecting cases).

FINRA also properly considered Fillet's misstatements during his subsequent OTR testimony as aggravating. Although this misconduct was outside the allegations of FINRA's complaint, FINRA may consider such evidence when assessing the appropriate sanction.⁸⁵ As the record showed, when asked by FINRA investigators if he had backdated documents in his OTR testimony, Fillet denied doing so and gave various excuses for the unsigned documents supplied by the branch office, including that the signed documents "got lost in the mail" or were contained "in different faxes."⁸⁶ These additional attempts to mislead FINRA further suggest that Fillet has a fundamental misunderstanding of his obligations as a securities professional.⁸⁷

Fillet challenges the sanctions as excessive, claiming that the sanctions are higher than those assessed in recent FINRA cases, but he cites no cases to support his broad claim. In any event, it is well established that "[t]he appropriate sanction . . . depends on the facts and circumstances of each case."⁸⁸ FINRA's sanctions are well within the range recommended by the Guidelines and, given the egregiousness of the violations, are neither excessive nor oppressive.⁸⁹

We also reject Fillet's claims of mitigation. Fillet claims that there was no harm to any customers and that he did not benefit from his wrongdoing. But we have long stated that "[t]he absence of monetary gain or customer harm is not mitigating, as our public interest analysis focus[es] . . . on the welfare of investors generally."⁹⁰ Fillet's deceptive acts created a danger that

⁸⁵ Cf., e.g., *J. Stephen Stout*, Exchange Act Release No. 43410, 54 SEC 888, 2000 WL 1469576, at *16 & n.64 (Oct. 4, 2000) (considering as aggravating conduct respondent's post-OIP misconduct in determining that a bar was appropriate); *Joseph J. Barbato*, Exchange Act Release No. 41034, 53 SEC 1259, 1999 WL 58922, at *15 (Feb. 10, 1999) (finding respondent's improper contact with witnesses to be indicative of potential to commit future violations and thus relevant to analysis in assessing sanctions).

⁸⁶ Fillet also provided a similar denial in his written correspondence at the time.

⁸⁷ See Sanction Guidelines, *supra* note 78, at 7 (recommending consideration of "whether the respondent attempted to delay FINRA's investigation, to conceal information from FINRA, or to provide inaccurate or misleading testimony or documentary information to FINRA").

⁸⁸ *World Trade Fin. Corp.*, 2012 WL 32121, at *16 (citing *Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973) ("The employment of a sanction within the authority of an administrative agency is thus not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases.")); cf. *Kornman*, 592 F.3d at 188 ("The Commission is not obligated to make its sanctions uniform." (quotation and citation omitted)).

⁸⁹ Moreover, FINRA's application of the Guidelines ensures "greater consistency, uniformity, and fairness in the sanctions that are imposed for violations." *Richard A. Neaton*, Exchange Act Release 65598, 2011 WL 5001956, at *12 n.38 (Oct. 20, 2011).

⁹⁰ E.g., *Howard Braff*, Exchange Act Release No. 66467, 2012 WL 601003, at *7 (Feb. 24, 2012); *vFinance*, 2010 WL 2674858, at *17. Nor does the absence of a customer complaint preclude sanction. *Maximo Justo Guevara*, Exchange Act Release No. 42793, 54 SEC 655, 2000 WL 679607, at *6 (Mar. 18, 2000) (stating that FINRA's "power to enforce its rules is

investors would be harmed by his failure to supervise the transactions, depriving customers of protections accorded to them by the recordkeeping requirements.

We also reject his claim that his prior compliance with FINRA rules is mitigating. Under the Guidelines, "while the existence of a disciplinary history may serve to enhance the sanction imposed, the '[l]ack of disciplinary history is not a mitigating factor.'"⁹¹ As we have stated, "member firms and their associated persons 'should not be rewarded for acting in accordance with [their] duties.'"⁹² The record further suggests that Fillet has a history of backdating documents: Besides the documents at issue, Fillet testified that he had a "habit" of not carefully dating materials, admitting that "I think, frankly, even blotters . . . I might have reviewed them a week later, two weeks late and dated them the date of the blotter"—conduct that also violates the recordkeeping requirements.⁹³

Accordingly, we find that the two-year suspension and \$10,000 fine imposed were neither excessive nor oppressive but remedial. As FINRA concluded, "Fillet's backdating of Firm documents and providing these false documents to FINRA exemplifies an ethical breach[,] . . . reflect[ing] on his ability to comply with regulatory requirements necessary to the proper functioning of the securities industry and protection of the public." Facing discovery of his supervisory lapses, Fillet chose to doctor Firm records and provide those false materials to FINRA staff. This misconduct subjected Riderwood's customers to undue risk, depriving them of protections under the Exchange Act and FINRA rules.⁹⁴ Moreover, Fillet attempted to subvert a FINRA examination, reflecting an attitude toward regulatory oversight incompatible with the principles of investor protection.⁹⁵ As a result, we believe Fillet poses a threat to investors,

(...continued)

independent of a customer's decision not to complain"), *petition denied*, 47 F. App'x 198 (3d Cir. 2000).

⁹¹ *CMG Institutional Trading, LLC*, 2009 WL 223617, at *9 (quoting *Rooms*, 444 F.3d at 1214).

⁹² *Id.* (quoting *Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 WL 4958612, at *6 (Nov. 8, 2006)).

⁹³ *John B. Busacca, III*, Exchange Act Release No. 63312, 2010 WL 5092726, at *6 n.26 (Nov. 12, 2010) ("Implicit in the recordkeeping rules is the precondition that information in these records be accurate." (quotation marks omitted)), *petition denied*, 449 F. App'x. 886 (11th Cir. 2011).

⁹⁴ *See Schellenbach v. SEC*, 989 F.2d 907, 913 (7th Cir. 1993) ("Schellenbach's falsification of records exposed [firm's] customers to undue risk and deprived investors of the protections Congress and the executive branch have put in place." (citing *Blaise D'Antoni & Assoc. v. SEC*, 289 F.2d 276, 277 (5th Cir. 1961))).

⁹⁵ *See Geoffrey Ortiz*, Exchange Act Release No. 58416, 2008 WL 3891311, at *9 (Aug. 22, 2008) ("[S]upplying false information to [FINRA] during an investigation . . . 'mislead[s] [FINRA] and can conceal wrongdoing' and thereby 'subvert[s]' [FINRA]'s ability to perform its regulatory function and protect the public interest." (quoting *Michael A. Rooms*, Exchange Act

(continued...)

warranting the suspension and fine imposed. The sanctions also serve the remedial goals of general and specific deterrence, encouraging Fillet and others to comply with recordkeeping obligations that are critical to operating in the securities industry and deterring against future attempts to mislead regulatory authorities during the course of examinations.⁹⁶

IV. CONCLUSION

FINRA's decision is sustained in part, set aside in part, and remanded. We sustain FINRA's finding that Fillet violated NASD Rules 3110 and 2110 by falsifying records and causing his Firm's records to be inaccurate. We also sustain FINRA's determination to suspend Fillet in all capacities for two years and fine him \$10,000 for these violations. We see no reason to delay imposition of these sanctions and, for purposes of Section 25(a) of the Exchange Act, deem the disposition of this portion of the case "the final order of the Commission."⁹⁷ We also sustain FINRA's findings that Fillet's misrepresentations and failure to disclose material information violated NASD Rules 2120 and 2110, and IM-2310-2. We also sustain FINRA's findings that Fillet's failure to disclose material information violated Section 10(b) of the Exchange Act, and Rule 10b-5(a) and (c) thereunder. But for the reasons given in this opinion, we set aside FINRA's findings that Fillet violated Exchange Act Rule 10b-5(b). We also set aside and remand for reconsideration the sanctions imposed for Fillet's violations of the antifraud provisions. The case is therefore remanded to FINRA for disposition consistent with this opinion.

An appropriate order will issue.⁹⁸

By the Commission (Chair WHITE and Commissioners AGUILAR, GALLAGHER, STEIN, and PIWOWAR).

Brent J. Fields
Secretary

(...continued)

Release No. 51467, 2005 WL 742738, at *5 (Apr. 1, 2005), *aff'd*, 444 F.3d 1208 (10th Cir. 2006)).

⁹⁶ "[G]eneral deterrence is not, by itself, sufficient justification for expulsion or suspension . . . [but] may be considered as part of the overall remedial inquiry." *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1066 (D.C. Cir. 2007) (quoting *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005)).

⁹⁷ 15 U.S.C. § 78y(a) (stating "[a] person aggrieved by a final order of the Commission . . . may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part").

⁹⁸ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75054 / May 27, 2015

Admin. Proc. File No. 3-15601

In the Matter of the Application of

MITCHELL H. FILLET
Rockville, MD

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING REVIEW PROCEEDINGS IN PART, SETTING ASIDE REVIEW
PROCEEDING IN PART, AND REMANDING REVIEW PROCEEDING IN PART

On the basis of the Commission's opinion issued this day, it is

ORDERED that FINRA's finding that Mitchell H. Fillet violated NASD Rules 3110 and 2110 by falsifying records and causing his Firm's records to be inaccurate and the sanctions imposed for this violation are sustained; and it is further

ORDERED that FINRA's findings that Mitchell H. Fillet's misrepresentations and failure to disclose material information violated NASD Rules 2120 and 2110, and IM-2310-2 and that Fillet's failure to disclose material information violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder are sustained; and it is further

ORDERED that FINRA's finding that Mitchell H. Fillet violated Exchange Act Rule 10b-5(b) is set aside; and it is further

ORDERED that the sanctions imposed by FINRA for the violations of NASD Rules 2120 and 2110, IM-2310-2, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder are vacated; and it is further

ORDERED that the proceeding is remanded to FINRA for reconsideration of sanctions for the violations of NASD Rules 2120 and 2110, IM-2310-2, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder in accordance with this opinion; and it is further

ORDERED that FINRA's imposition of costs on Mitchell H. Fillet is sustained.

By the Commission.

Brent J. Fields

Secretary