SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 77492 / March 31, 2016

Admin. Proc. File No. 3-16360

In the Matter of the Applications of

WILLIAM SCHOLANDER
and
TALMAN HARRIS

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DISCIPLINARY PROCEEDINGS

Fraudulent Omissions

Failure to Provide Written Notice to Firm of Outside Business Activities

Conduct Inconsistent with Just and Equitable Principles of Trade

Registered representatives omitted material facts when recommending securities and engaged in outside business activities without providing prompt written notice to member firm. *Held*, association's findings of violations and sanctions imposed are *sustained*.

APPEARANCES:

Paula D. Shaffner, *Amy E. Sparrow*, and *Adriel Garcia*, of Stradley, Ronon, Stevens & Young, LLP, Philadelphia, PA, and *Jon-Jorge Aras*, of Spadea, Lanard & Lignana LLC, Philadelphia, PA, for William Scholander and Talman Harris.

Alan Lawhead and Michael Garawski, for FINRA.

Appeal filed: January 28, 2015
Last brief received: May 27, 2015

William Scholander and Talman Harris ("Applicants") appeal from a FINRA disciplinary action in which FINRA found that they violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010 when they recommended that customers buy the securities of Deer Consumer Products, Inc. ("DEER") without disclosing to those customers that a few months earlier DEER had paid them $350,000.[1] FINRA also found that Scholander and Harris violated NASD Rule 3030 and FINRA Rule 2010 when they engaged in outside business activities without providing prompt written notice to Seaboard Securities, Inc. ("Seaboard"), their FINRA member firm employer at the time.[2] For the fraud violations, FINRA barred Applicants from associating with FINRA member firms in any capacity. For the Rule 3030 violations, FINRA found that a $15,000 fine and a three-month suspension would be an appropriate sanction for each Applicant, but declined to impose those sanctions in light of the bars.

In their appeal of FINRA's findings of fraud, Applicants claim that they lacked scienter and had no obligation to disclose to customers their receipt of the $350,000 payment. Based on our independent review of the record, we reject Applicants' contentions and sustain FINRA's findings of violations and imposition of sanctions.[3]

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[1] Scholander and Harris entered the securities industry in the 1990s, and have been associated over the course of their careers with thirteen and sixteen FINRA member firms, respectively. Their most recent employer terminated their registrations on January 20, 2015, and neither Applicant is currently registered with a FINRA member firm.

[2] At the time of the conduct at issue, NASD Rule 3030 provided that "[n]o person associated with a member in any registered capacity shall be employed by, or accept compensation from, any other person as a result of any business activity . . . outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member."

On July 26, 2007, the Commission approved a proposed rule change that NASD filed seeking to amend its Certificate of Incorporation to reflect its name change to the Financial Industry Regulatory Authority, Inc. ("FINRA"), in connection with the consolidation of its member firm regulatory functions with NYSE Regulation, Inc. *See* Securities Exchange Act Release No. 56148, 2007 WL 2159604, at *2 (July 26, 2007). Following the consolidation, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* Exchange Act Release No. 58643 (Sept. 25, 2008), 73 Fed. Reg. 57,174 (Oct. 1, 2008). In December 2010, after the conduct at issue, the Commission approved the new FINRA Rule 3270, which replaced NASD Rule 3030. The new rule, among other things, clarified the types of positions an associated person could not hold with an outside business, and it specifically required that the associated person provide written notice to the member *before* engaging in outside business activities. *See FINRA Regulatory Notice 10-49* (Dec. 2010).

[3] In addition to the bars FINRA imposed, it also ordered Applicants to pay hearing costs totaling $7,089.79 (with each Applicant paying one half of this amount) and appeal costs of $1,319.04 each.

I. Facts

A. Applicants' Connections to DEER

Applicants first learned of DEER from Benjamin Wey ("Wey") and Wey's company, New York Global Group ("NYGG"). Wey and NYGG were in the business of locating U.S.-listed public shell companies for Chinese issuers so that the Chinese issuers could complete a "reverse merger" into the listed company.[4] Between 2002 and 2010, Applicants worked closely with Wey and Robert Newman ("Newman"), outside counsel for the Chinese issuers, to sell private placement shares for some of the issuers that had completed reverse mergers. Beginning in March and May 2009, respectively, Scholander and Harris were associated with Seaboard and continued their work with Chinese issuers to which Wey and Newman introduced them.

DEER was one of those issuers. DEER purported to be a designer and manufacturer of home and kitchen electrical appliances, and its stock was listed on the NASDAQ stock market. Applicants first sold DEER securities to customers in 2008.[5] In November 2009, Wey and Newman suggested that Scholander visit DEER's corporate offices in China. Scholander visited China for two days, accompanied by Maureen Gearty. Gearty had been helping Applicants and Ronen Zakai ("Zakai"), a representative at a different member firm, purchase a broker-dealer firm. According to Gearty's hearing testimony, Scholander and Gearty spent "two hours tops" at DEER's offices and performed some consulting work during those two hours concerning DEER's products and DEER's investment banking advisors.[6] In his on-the-record interview, Scholander

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[4] In a "reverse merger," a private company arranges to be acquired by a public shell company, with the shell company surviving and the former shareholders of the private business receiving shares of the shell and controlling that surviving entity. *See Use of Form S-8, Form 8-K, and Form 20-F by Shell Companies*, Securities Act of 1933 Release No. 8587, 2005 WL 1667452, at *2 (July 15, 2005); *see also SEC v. Cavanagh*, 445 F.3d 105, 108 n.4 (2d Cir. 2006) (discussing mechanics of a reverse merger).

On September 10, 2015, we filed a complaint in federal district court alleging that Wey and New York Global Group, as well as several affiliated persons, violated the antifraud and reporting provisions of the federal securities laws, in that they "obtain[ed] control of and manipulate[ed] the stock of Chinese companies they were purportedly guiding through the process of raising capital and becoming publicly-traded in the United States." *SEC v. Benjamin Wey*, Civil Action No. 15-cv-7116 (S.D.N.Y. Sept. 10, 2015), Litigation Release No. 23342, 2015 WL 5258844, at *1 (Sept. 10, 2015). One of the issuers whose stock we alleged that Wey manipulated was DEER. In a parallel action, the United States Attorney's Office for the Southern District of New York concurrently filed criminal charges against Wey. As of the date of this opinion, the civil and criminal matters were still pending.

[5] The Applicants' sales of DEER securities in 2008 were private placements. Scholander testified that Applicants received compensation for their participation in these private placements of "10 percent cash and 10 percent warrants [to purchase DEER securities]."

[6] Gearty testified at the hearing that she and Scholander looked at coffee and waffle makers at DEER's offices, that a DEER official's driver "took us to the mall to see the DEER Consumer products display" at a "[Chinese] J.C. Penney," and that they "went to a flea market and

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stated that Applicants provided additional advice to DEER during "a couple of calls" and referred to the fee as an "advisory fee," which was to be paid to First Merger for "giving . . . opinions [on] the company and what they can do to improve and appeal to the investors." When asked why First Merger received the fee, Scholander explained that he had discussed with DEER officials in China "how they're going to grow" and that Scholander supported DEER's decision to choose a certain investment bank.

On December 17, 2009, after Scholander and Gearty returned from China, DEER paid $350,000 into a bank account for an entity named First Merger Delaware that had been created by Gearty for the purpose of receiving the payment.[7] Although the payment was made to First Merger Delaware, the Applicants and Zakai directed Gearty to use the money to pay expenses associated with the acquisition of the broker-dealer firm and the opening of a new branch office for that firm. Between December 21, 2009 and February 4, 2010, Applicants and Zakai used the entire $350,000.

B. Applicants' Recommendation of DEER Securities to Customers

On February 9, 2010, Applicants left Seaboard and shortly thereafter became registered with the broker-dealer firm that was their acquisition target (First Merger, Inc.). From February through November 2010, First Merger brokers, including Applicants, recommended that customers buy DEER securities and sold $2,942,299 of DEER securities to 132 First Merger customers.[8] One or both Applicants were listed as the registered representatives for 42 of the 132 accounts that purchased DEER securities. Sales of DEER securities to those 42 accounts totaled $961,852.68 and generated $13,700 in commissions. Scholander and Harris both acknowledged in their hearing testimony that when they recommended DEER securities to customers, they did not disclose the $350,000 payment or their business relationship with DEER.

C. Applicants' Outside Business Activities

Applicants did not disclose to Seaboard the limited consulting services that they provided to DEER in China and on a "couple of calls" while they were associated with Seaboard; nor did

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shopped." Gearty testified at a continuing membership interview that the consulting services she provided consisted of telling DEER which products she liked and didn't like. She stated that she had no other meetings with DEER officials.

Scholander similarly testified at an on-the-record interview that when they were in China, he and Gearty provided advice to DEER about their products and how to market them. Scholander later claimed during the hearing that only Gearty had provided advice and that the $350,000 fee belonged to Gearty.

[7] Given that Scholander and Gearty spent very little time with DEER officials and provided minimal advice related to the company's growth and its strategy in adding investors, Gearty testified at the hearing that the attitude of Applicants was "like a big giggle" because "[Gearty and Scholander] went there and it was the easiest [money] ever."

[8] Applicants do not dispute that they used the telephone to recommend and sell DEER securities to customers.

they disclose to Seaboard the $350,000 wired to the First Merger Delaware account for their benefit.

Scholander did not disclose to Seaboard that he provided consulting services to DEER during his trip to China. In fact, Scholander testified at the hearing that he orally told the Seaboard compliance officer in November 2009 only that he was "going to China on a due diligence road show." Neither Scholander nor Harris disclosed to Seaboard that they provided consulting services in conference calls with DEER. And neither Applicant disclosed to Seaboard that DEER had compensated them.

D. Procedural History

A FINRA Hearing Panel found Scholander and Harris liable on two of the three counts charged in FINRA's January 31, 2012 complaint: (i) that Applicants sold DEER securities to First Merger customers while misleadingly omitting to disclose their business relationship with DEER or DEER's payment to them of $350,000, in violation of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010; and (ii) that Applicants engaged in undisclosed outside business activities during their employment at Seaboard, in violation of NASD Rule 3030 and FINRA Rule 2010.[9] The Hearing Panel barred Applicants in all capacities for their fraudulent omissions. In light of the bars it imposed, the Hearing Panel declined to impose any additional sanctions for Applicants' outside business activities violations, but stated that a $10,000 fine for each Applicant would have been an appropriate sanction.

Scholander and Harris appealed the Hearing Panel's decision to FINRA's National Adjudicatory Council. The NAC affirmed the Hearing Panel's decision and the bars imposed for the fraudulent omissions. The NAC found that Applicants' outside business activities violations were not egregious, but noted the presence of certain aggravating factors and stated that it would have fined each Applicant $15,000 and suspended them in all capacities for three months for those violations. Like the Hearing Panel, the NAC declined to impose those sanctions in light of the bars it imposed for their fraudulent omissions. Applicants subsequently filed this timely appeal.

II. Analysis

A. Standard of Review

We base our findings on an independent review of the record and apply the preponderance of the evidence standard for self-regulatory organization disciplinary actions.[10]

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[9] The Hearing Panel dismissed a third cause of action against Applicants, which charged that they had caused First Merger to commit books and records violations because Applicants "were paid their commissions in an unorthodox manner through another individual's personal account," finding that FINRA's Department of Enforcement had failed to prove this charge by a preponderance of the evidence. The FINRA Department of Enforcement did not appeal this portion of the Hearing Panel's decision to FINRA's National Adjudicatory Council, and it is not at issue in this appeal.

[10] *See David M. Levine*, Exchange Act Release No. 48760, 2003 WL 22570694, at *9 n.42 (Nov. 7, 2003).

Under Exchange Act Section 19(e)(1), in reviewing an SRO disciplinary action, we determine whether the aggrieved person engaged in the conduct found by the SRO, whether such conduct violates the relevant statutes and rules as found by the SRO, and whether such SRO rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.[11]

B. Conduct found by FINRA

We find that Scholander and Harris engaged in the conduct found by FINRA. As described above, the evidence in the record establishes that Applicants had a business relationship with and received a $350,000 payment from DEER. Scholander traveled to DEER's headquarters in China and purportedly provided approximately two hours of consulting services during that trip, and Applicants provided additional consulting services during two conference calls before and after the China trip. The record also establishes that DEER paid $350,000 into an account that Applicants used for expenses related to their own business venture. Applicants admit that less than two months later, they recommended that their customers buy DEER securities, and that they did not disclose to these customers that they had received the payment or had a business relationship with DEER. Applicants sold $961,852.68 worth of DEER securities to 42 customers over the course of ten months in 2010.

In the context of Applicants' later recommendation of DEER securities to customers at First Merger, it appears that DEER's $350,000 payment compensated Applicants for both the limited consulting services[12] and their recommendation that customers buy DEER securities.[13]

C. Fraudulent omissions

Based on these facts, we sustain FINRA's findings that Applicants violated Exchange Act Section 10(b), Rule 10b-5 thereunder. To establish a violation of Exchange Act Section 10(b) and Rule 10b-5(b) thereunder, FINRA must show that Applicants: (1) used any means or instrumentality of interstate commerce or of the mails; [14] (2) to make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading;[15] (3) with scienter; [16] (4) in connection with the purchase or sale of securities.[17]

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11 15 U.S.C. § 78s(e)(1).

12 If the payment really was intended to compensate Applicants solely for their consulting services, which totaled four hours at most, DEER paid Applicants at a rate of $87,500 per hour.

13 Applicants' business relationship with DEER extended beyond the trip to China and the conference calls. In 2008, Applicants had handled two private placements for DEER, and in November 2009, while associated with Seaboard, they attempted to negotiate a contract to provide DEER with advisory services in connection with DEER's follow-on offering. *See supra* note 5.

14 15 U.S.C. § 78j(b).

15 17 C.F.R. § 240.10b-5(b).

16 *See Aaron v. SEC*, 446 U.S. 680, 697 (1980).

17 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

A violation of Exchange Act Section 10(b) is sufficient to establish a violation of FINRA Rule 2010. FINRA Rule 2010 requires members and their associated persons to observe "high standards of commercial honor and just and equitable principles of trade," and a violation of the Exchange Act or any FINRA rule constitutes a violation of Rule 2010.[18] A violation of Exchange Act Section 10(b) also constitutes a violation of FINRA Rule 2020, which prohibits FINRA members from "effect[ing] 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."[19]

1. Instrumentality of interstate commerce

Applicants do not dispute that they used the telephone to place calls to customers when recommending DEER securities. Their use of the telephone satisfies the interstate commerce jurisdictional element of Exchange Act Section 10(b) and Rule 10b-5.[20]

2. Omission of material fact

"When recommending securities to a prospective investor, a securities professional must not only avoid affirmative misstatements but also must disclose 'material adverse facts,' including any self-interest that could influence the salesman's recommendation."[21] Investors "must be permitted to evaluate overlapping motivations through appropriate disclosures, especially where one motivation is economic self-interest."[22] Applicants recommended that customers buy DEER securities while omitting the fact that DEER had paid them $350,000.

We reject Applicants' contention that they had no obligation to disclose any information, including the $350,000 payment, unless it was related to the narrow task of consummating purchases of DEER securities by Applicants' customers. Applicants' violation does not turn on whether the payment was related to the purchases of DEER securities, but rather on their failure

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18 *See, e.g., E. Magnus Oppenheim & Co.*, Exchange Act Release No. 51479, 2005 WL 770880, at *2 (Apr. 6, 2005) (finding that violation of Exchange Act or other FINRA Rules constitutes a violation of Rule 2010's predecessor, NASD Rule 2110).

19 *See, e.g., Donner Corp. Int'l*, Exchange Act Release No. 55313, 2007 WL 516282, at *13 (Feb. 20, 2007) (finding that the same conduct—omissions of material facts in research reports that rendered the reports misleading—violated both Section 10(b) and FINRA Rule 2020's predecessor, NASD Rule 2120).

20 *See SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 865 (S.D.N.Y. 1997) (finding that even intrastate telephone calls satisfy the interstate commerce jurisdictional requirements of the federal antifraud provisions), *aff'd*, 159 F.3d 1348 (2d Cir. 1998).

21 *Richard H. Morrow*, Exchange Act Release No. 40392, 1998 WL 556560, at *6 & n.16 (Sept, 2, 1998) (citing *Gilbert A. Zwetsch*, Exchange Act Release No. 30092, 50 SEC 816, 1991 WL 288614, at *2 (Dec. 18, 1991)).

22 *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1171-72 (2d Cir. 1970). *Cf. SEC v. Hasho*, 784 F. Supp. 1059, 1107 (S.D.N.Y. 1992) (citing *Hanly v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969) ("By making a recommendation, a securities dealer implicitly represents to a buyer of securities that he has an adequate basis for the recommendation.")).

to disclose the self-interested transaction they had entered into with the issuer prior to recommending and selling its securities. "When a broker-dealer has a self-interest (other than the regular expectation of a commission) in serving the issuer that could influence its recommendation, it is material and should be disclosed."[23] The failure to disclose the $350,000 payment is, on its own, sufficient to support FINRA's finding of fraud.[24] Applicants' failure to disclose their business relationship with DEER also violated their duty to disclose a conflict of interest to their customers.[25]

Applicants rely on *Press v. Chemical Investment Services Corp*. in support of their argument.[26] In *Press*, the Second Circuit sustained the district court's finding that the markup on a transaction in Treasury bills was not excessive and that the defendant broker was not required to disclose the markup where the broker's relationship with the customer was limited to the consummation of that one transaction.[27] The Second Circuit recognized that, although a broker does not owe a fiduciary duty to a customer in an ordinary broker-customer relationship, the broker does owe an obligation to the customer as to matters entrusted to the broker.[28] For those matters, the broker must use reasonable efforts to provide the customer with significant relevant information.[29] Instead of supporting Applicants' contention, *Press* lends support to a finding of violation because the Applicants failed to provide significant information that was relevant to the specific recommendation that Applicants made to customers.

As to the materiality of the omissions, under the basic test of materiality—whether there is a substantial likelihood that a reasonable investor would have considered the fact important in making an investment decision[30]—the payment was a material fact in the context of Applicants'

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23 *Kevin D. Kunz*, Exchange Act Release No. 45290, 55 SEC 551, 2002 WL 54819, at *6 & n.30 (Jan. 16, 2002).

24 *See, e.g., United States v. Nouri*, 711 F.3d 129, 142 (2d Cir. 2013) ("If a broker has been bribed by the issuer of a security to get his customers to buy that security, the broker's failure to tell the customer of the fact of the bribe offer while recommending the purchase of the security . . . is, as a matter of law, the omission of a material fact, which the broker is under a duty to reveal."); *Derek L. DuBois*, Exchange Act Release No. 48332, 2003 WL 21946858, at *3 (Aug. 13, 2003) (finding antifraud violations where a broker recommended securities but failed to disclose that he was being compensated by the promoter of the stock).

25 *Kunz*, 2002 WL 54819, at *4 (finding anti-fraud violation where the broker failed to disclose, among other things, a consulting relationship the broker had with the issuer of securities he recommended).

26 *Press v. Chem. Inv. Servs. Corp*., 166 F.3d 529, 536 (2d Cir. 1999).

27 *Id.*

28 *Id.*

29 *Id.*

30 *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). The question of materiality is objective and is not dependent on whether the specific investors affected considered the information to be material. *See TSC Indus., Inc. v. Northway*, 426 U.S. 438, 445 (1976).

affirmative recommendation that customers buy DEER securities. There is a substantial likelihood that a reasonable investor would have considered DEER's payment of $350,000 to Applicants important to an evaluation of Applicants' recommendation to buy DEER securities and, ultimately, to an investment decision.[31] At a minimum, the payment from DEER had the potential to influence Applicants' recommendation of DEER securities, and it casts doubt on the sincerity of Applicants' recommendation to buy DEER stock.[32]

The payment from DEER provided Applicants with an economic self-interest that created a conflict because it may have motivated their later recommendation that customers purchase DEER securities. Therefore, we find that in the context of their recommendations to buy DEER securities, Applicants were required to disclose the payment. Their nondisclosure was an omission of material fact.

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[31] *See, e.g., Nouri*, 711 F.3d at 142 (stating that an issuer's bribe in exchange for a broker's recommendation is material because "[a]t the very least it suggests the customer should seriously question the genuineness or reliability of the recommendation"); *Chasins*, 438 F.2d at 1171 ("In this situation, failure to inform the customer fully of [Smith, Barney's] possible conflict of interest, in that it was a market maker in the securities which it strongly recommended for purchase by [the plaintiff], was an omission of material fact in violation of Rule 10b-5, 17 C.F.R. 240.10b-5.").

[32] FINRA stated that "respondents have offered no proof that the $350,000 was compensation for selling stock" and that the DEER payment "reflected a single, substantial, non-transaction-based payment from an issuer in exchange for consulting services," FINRA decision at 23, but FINRA also noted that "it is reasonable to infer that DEER did not make the $350,000 payment for no reason at all, and that the limited 'advisory services' that Scholander and Harris provided were not the only services that DEER expected for its money." FINRA Decision at 20-21.

The $350,000 payment occurred prior to the Applicants' recommendations of DEER securities and, as a result, was not tied to a specific transaction (and was not a "transaction-based payment"), but it nevertheless should have been disclosed to customers. Based on the circumstances and limited advisory services provided by Applicants, it appears that the payment was a form of *quid pro quo* for later, general recommendations of DEER securities by Applicants.

We agree with FINRA that even if the $350,000 was not "transaction-based compensation," it is also not in the same category as employer compensation that an associated person is not required to disclose absent a fiduciary duty (such as transaction-based commissions on principal trades). FINRA decision at 23-24 n.31. Customers would not expect their broker to receive such substantial compensation from the issuer of the securities that the broker recommends.

3. Scienter

Scienter is "a mental state embracing intent to deceive, manipulate, or defraud."[33] Scienter includes recklessness, conduct that is "an extreme departure from the standards of ordinary care … to the extent that the danger [of deceiving investors] was either known to the [applicant] or so obvious that the [applicant] must have been aware of it."[34]

Applicants acted at least recklessly. Applicants knew that DEER had wired $350,000 into the account of First Merger Delaware for their benefit. Applicants directed Gearty to spend the money on expenses related to their own business venture. When Applicants began to recommend that customers buy DEER securities within just a couple of months after receiving the payment, they knew or were reckless in not knowing that the fact of the payment, and their relationship with DEER, would be material to customers who were evaluating Applicants' recommendation.

Applicants claim that they did not act with scienter because their material omissions fall into what they describe as a "grey area" of the law and thus their conduct was not an "extreme departure." Applicants claim that "no one at First Merger or acting on behalf of First Merger who was aware of the fee—which included a securities lawyer and the Chief Compliance Officer at the firm who held a Series 24 license and was also the supervisor of the trades—thought that it needed to be disclosed."

To the extent that Applicants refer to the chief compliance officer's purported awareness of the $350,000 payment, Applicants cite no evidence, and we find none in the record, to suggest that the chief compliance officer knew Applicants were not disclosing the payment to customers. Moreover, we have held that associated persons are responsible for their own compliance and cannot shift that responsibility to a supervisor or to FINRA.[35] Further, even if the chief compliance officer had known about, or even acquiesced to, Applicants' omissions, this would not defeat a finding of scienter because Applicants, as experienced securities industry professionals, knew or were reckless in not knowing that the omitted information would be material to a reasonable investor.[36]

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33 *Aaron*, 446 U.S. at 686 n.5 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976)).

34 *Dolphin & Bradbury, Inc. 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)). Scienter may be demonstrated by circumstantial evidence. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983); *Valicenti Advisory Servs., Inc. v. SEC*, 198 F.3d 62, 65 (2d Cir. 1999).

35 *Scott Epstein*, Exchange Act Release No. 59328, 2009 WL 223611, at *21 (Jan. 30, 2009) ("We have repeatedly held that a 'respondent cannot shift his or her responsibility for compliance with an applicable requirement to a supervisor or to the NASD.'") (citation omitted), *aff'd*, 416 F. App'x 142 (3d Cir. 2010).

36 *See Orlando Joseph Jett*, Exchange Act Release No. 49366, 2004 WL 2809317, at *20 (Mar. 5, 2004) (rejecting applicant's claim that he lacked scienter because, among other reasons, he provided "full access to his desk and traders during the internal audit" and stating that even if

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Applicants also assert that a securities attorney who assisted Applicants with the purchase of First Merger was aware of the $350,000 payment. Applicants argue that the attorney did not tell them to disclose the $350,000 payment. But Applicants do not claim to have consulted this attorney about their disclosure obligations when selling DEER securities to customers. If Applicants seek to assert that they lacked scienter because they relied on advice of counsel,[37] Applicants must show: (1) that they made complete disclosure to counsel; (2) that they sought advice on the legality of the intended conduct; (3) that they received advice that the intended conduct was legal; and (4) that they relied in good faith on counsel's advice.[38] Applicants have not satisfied any of these requirements. Applicants knew that they received the $350,000 payment and failed to disclose it to their customers when recommending DEER securities, and knew or were reckless in not knowing that the omitted information would be material to their customers.

We therefore find that Applicants acted with the requisite scienter to sustain a violation of the antifraud provisions.

4. In connection with the purchase or sale of securities

The Commission has "consistently adopted a broad reading of the 'in connection with' requirement."[39] We find that Applicants' omissions were in the context of recommending that customers purchase DEER securities, and, as a result, those omissions were "in connection with" the customers' purchases of securities.[40]

(…continued)
applicant's "supervisors and co-workers knew about his fraud on the firm—indeed even if they ordered him to commit it—that would not relieve Jett of responsibility for what he knew or was reckless in not knowing and for what he did").

[37] *SEC v. Howard*, 376 F.3d 1136, 1147 (D.C. Cir. 2004) (stating that "reliance on the advice of counsel need not be a formal defense; it is simply evidence of good faith, a relevant consideration in evaluating a defendant's scienter") (citing *Bisno v. United States*, 299 F.2d 711, 719 (9th Cir. 1961)).

[38] *Zacharias v. SEC*, 569 F.3d 458, 467 (D.C. Cir. 2009); *Markowski v. SEC*, 34 F.3d 99, 105 (2d Cir. 1994); *C.E. Carlson v. SEC*, 859 F.2d 1429, 1436 (10th Cir. 1988); *SEC v. Goldfield Deep Mines Co. of Nevada*, 758 F.2d 459, 467 (9th Cir. 1985); *SEC v. Savoy Indus., Inc.*, 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981). *See also Joseph J. Vastano*, Exchange Act Release No. 50219, 2004 WL 1857139, at *5 & n.22 (Aug. 19, 2004); *Anthony H. Barkate*, Exchange Act Release No. 49542, 2004 WL 762434, at *4 & nn.19-20 (Apr. 8, 2004); *Toni Valentino*, Exchange Act Release No. 49255, 57 SEC 330, 2004 WL 300098, at *5 & n.11 (Feb. 13, 2004).

[39] *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).

[40] Applicants do not dispute that their omissions were in connection with the purchase of securities.

Based on our findings above, we sustain FINRA's determination that Applicants' conduct violated Exchange Act Section 10(b), Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010.

5. Applicants' other contentions

a. Fiduciary Duty

Applicants' argument that they did not owe their customers a fiduciary duty is irrelevant. Applicants' liability for fraud violations does not turn on whether they owed their customers a fiduciary duty. Their liability is based on the fact that they recommended that customers purchase DEER securities while omitting material facts concerning their recommendation.

Applicants rely on *United States v. Skelly*, in which the Second Circuit affirmed respondents' convictions for securities fraud, including violations of Section 10(b) and Rule 10b-5, as a result of their pump-and-dump scheme.[41] The *Skelly* court also found that a secondary theory of liability had failed. This secondary theory turned on the respondents' failure to disclose that the broker was paying its registered representatives high commissions for selling the relevant security. The court found that the district court failed properly to instruct the jury on the elements of a fiduciary duty, which was required to impose liability for the secondary theory of liability.[42]

But *Skelly* is not applicable to this case. Unlike in *Skelly*, Applicants received compensation from the *issuer* of the securities they recommended, rather than from their employer. As the Second Circuit made clear in *Nouri*, a *quid pro quo* payment from an issuer must be disclosed in the context of a recommendation that a customer buy that issuer's securities.[43] Applicants cite to no case to suggest the kinds of payments they received from DEER need not be disclosed, and for the reasons stated above, even in the absence of fiduciary duty, Applicants should have disclosed the $350,000 payment from DEER to their customers.

b. Gearty's testimony

In their reply brief, Applicants complain about FINRA's reliance on Gearty's testimony, stating that Gearty "lied under oath to FINRA." All of FINRA's findings are corroborated by evidence other than Gearty's testimony, including by Applicants' own admissions. Gearty's testimony is not essential to our decision to sustain FINRA's findings. But we also find that the record supports FINRA's credibility findings as to the testimony of Applicants and Gearty.[44] We

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41 *United States v. Skelly*, 442 F.3d 94, 97 (2d Cir. 2006).

42 The court affirmed the convictions, finding that the defendants had not objected to the jury instructions during the trial, and the court's failure to instruct the jury on all elements did not constitute plain error because the primary theory of liability was supported by "overwhelming proof." *Id.* at 98-99.

43 *Nouri*, 711 F.3d at 142-43.

44 With respect to Gearty's testimony, the Hearing Panel was aware that during her OTR she failed to acknowledge that Wey suggested that she and Scholander visit DEER in China, but determined that overall she was a credible witness based on her demeanor and the level of detail she provided, as well as her testimony's consistency with other evidence.

agree with FINRA that Applicants' testimony regarding the timing of the China trip and what they did in exchange for the $350,000 payment was not credible. We will not disturb FINRA's credibility findings.[45]

D. Outside Business Activities

NASD Rule 3030 stated that, "[n]o person associated with a member in any registered capacity shall be employed by, or accept compensation from, any other person as a result of any business activity . . . outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member."

Applicants admit that they failed to provide Seaboard with any written notice of the consulting services they provided to DEER or their receipt of the $350,000 payment. To the extent that Applicants contend that they provided oral notice of their activities to Seaboard, their purported oral notice did not disclose any outside business activity or compensation. Applicants only told Seaboard that they were going to China on a "due diligence" trip, which would be related to their employment at Seaboard. In any event, constructive or oral notice of outside business activities does not satisfy the requirements of Rule 3030 that registered representatives provide their member firms with prompt written notice of such activities.[46] We therefore sustain FINRA's finding that Applicants violated NASD Rule 3030 by engaging in undisclosed outside business activities.[47]

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[45] Such determinations, based on hearing the witness's testimony and observing demeanor, are entitled to considerable deference. *See Wanda P. Sears*, Exchange Act Release No. 58075, 2008 WL 2597567, at *2 (July 1, 2008) (quoting *Jon R. Butzen*, Exchange Act Release No. 36512, 52 SEC 512, 1995 WL 699189, at *2 & n.7 (Nov. 27, 1995) ("[T]he credibility determination of the initial decision maker [in a FINRA disciplinary proceeding] is entitled to considerable weight and deference, since it is based on hearing the witnesses' testimony and observing their demeanor.")).

[46] *See id.* at *4 & n.24.

[47] *See Kent M. Houston*, Exchange Act Release No. 66014, 2011 WL 6392264, at *7 (Dec. 20, 2011) (finding violations of NASD Rules 3030 and 2110 where representative failed to provide written notice to member firm of his service as a trustee and his receipt of compensation for that role); *Sears*, 2008 WL 2597567, at *5 (finding violations of NASD Rules 3030 and 2110 where representative prepared tax returns for clients for compensation without providing written notice to member firm). These violations also constitute violations of FINRA Rule 2010, which require members to observe "high standards of commercial honor and just and equitable principles of trade." *See supra* note 18.

E. The relevant FINRA and NASD Rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.

We find that the relevant FINRA and NASD Rules are, and were applied in a manner, consistent with the purposes of the Exchange Act. FINRA Rule 2020 protects investors by prohibiting the same type of conduct that is prohibited by Exchange Act Section 10(b) and Rule 10b-5. We therefore find that Rule 2020 is consistent with the purposes of the Exchange Act. FINRA applied FINRA Rule 2020 in a manner consistent with the Exchange Act. As described above, FINRA's findings that the Applicants' conduct violated FINRA Rule 2020 are supported by a preponderance of the evidence.

NASD Rule 3030 is consistent with the purposes of the Exchange Act because requiring prompt written disclosure of outside business activities allows member firms to raise any objections in a timely manner and to exercise appropriate supervision of the activities of registered persons.[48] FINRA's determination that the Applicants violated Rule 3030 is supported by a preponderance of the evidence and, thus, was applied in a manner consistent with the purposes of the Exchange Act.

Finally, we find that FINRA Rule 2010 is consistent with the purposes of the Exchange Act because it reflects the mandate of Exchange Act Section 15A(b)(6), which requires, among other things, that FINRA design its rules to "promote just and equitable principles of trade."[49] This standard "provides more flexibility than prescriptive regulations and legal requirements" and, thus, prohibits dishonest practices even if those practices may not be illegal or violate a specific rule.[50] Therefore, Rule 2010 is consistent with the purposes of the Exchange Act. We find that FINRA also applied Rule 2010 in a manner consistent with the purposes of the Exchange Act. The same conduct that violated FINRA Rule 2020 and NASD Rule 3030 also violated FINRA Rule 2010.

III. Sanctions

A. Standard of Review

Exchange Act Section 19(e)(2) directs us to sustain FINRA's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are

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48 *See Order Approving Proposed Rule Change Relating to Outside Business Activities of Associated Persons of Member Firms*, Exchange Act Release No. 26178, 1988 WL 902783, at *1 (Oct. 13, 1988) (approving NASD's enactment of Rule 3030 to address the securities industry's growing concern about preventing harm to the investing public or a firm's entanglement in legal difficulties based on an associated person's unmonitored outside business activities).

49 15 U.S.C. § 78o-3(b)(6).

50 *Notice of Filing of a Proposed Rule Change*, Exchange Act Release No. 58095, 2008 WL 2971979, at *2 (July 3, 2008); *see also Rule Change Approved Without Modification*, Exchange Act Release No. 58643, 2008 WL 4468749, at *2 (Sept. 25, 2008).

excessive or oppressive or impose an unnecessary or inappropriate burden on competition.[51] As part of this review, we must consider any aggravating or mitigating factors[52] and whether the sanctions imposed by FINRA are remedial in nature and not punitive.[53] Although the Commission is not bound by FINRA's Sanction Guidelines, we use them as a benchmark in conducting our review under Section 19(e)(2).[54] As discussed below, we find the sanctions imposed on Applicants to be consistent with the statutory requirements and sustain them.

B. The bars are neither excessive nor oppressive.

Fraud violations such as those at issue here are "especially serious and subject to the severest of sanctions under the securities laws."[55] For intentional or reckless material omissions, the Guidelines recommend a fine between $10,000 and $100,000, a suspension in any and all capacities of ten business days to two years, and, in egregious cases, a bar.[56]

We find, as did FINRA, that several aggravating factors demonstrate that Applicants' misconduct is egregious and warrants a bar. Specifically, Applicants: (1) sold nearly $1 million in DEER securities to 42 customers over a nine-month period, acting at least recklessly in failing to disclose the payment;[57] (2) engaged in misconduct that provided them with a monetary gain;[58] and (3) provided inaccurate or misleading testimony to FINRA investigators regarding the receipt of the $350,000 payment, the timing of the visit to DEER's facilities in China, and, in

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51 15 U.S.C. § 78s(e)(2). Applicants do not allege, and the record does not show, that FINRA's sanctions imposed an undue burden on competition.

52 *Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013); *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1064-65 (D.C. Cir. 2007).

53 *PAZ Sec.*, 494 F.3d at 1065 ("'The purpose of the order [must be] remedial, not penal.'") (quoting *Wright v. SEC*, 112 F.2d 89, 94 (2d Cir. 1940)); *see also* FINRA Sanction Guidelines at 2 ("Disciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry.").

54 *See, e.g., John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 WL 2898033, at *11 (June 14, 2013).

55 *Marshall E. Melton*, Investment Advisers Act of 1940 Act Release No. 2151, 56 SEC 695, 2003 WL 21729839, at *9 (July 25, 2003).

56 *See* FINRA Sanction Guidelines, at 88.

57 *See id.* at 6, 7 (providing that principal considerations in the determination of sanctions include the number, size, and character of the transactions at issue; whether the conduct occurred over an extended period of time; and whether the misconduct was the result of an intentional act, recklessness, or negligence).

58 *Id.* at 7 (providing that a principal consideration in the determination of sanctions is whether the respondent's misconduct resulted in the potential for respondent's monetary or other gain).

Harris's case, about whether he knew that the $350,000 was spent on expenses related to opening First Merger.[59]

Applicants claim that FINRA should not have considered the number and dollar amount of their customers' purchases of DEER securities as an aggravating factor, arguing that FINRA should have treated their misconduct as a "single, isolated incident." As Applicants note, the Sanction Guidelines authorize the aggregation or "batching" of violations for purposes of determining sanctions if, among other things, the violations result from a single systemic problem or cause.[60] But by imposing a unitary sanction, FINRA did in fact batch Applicants' violations, rather than imposing a separate sanction for each fraudulent sale of DEER securities.

Applicants argue that FINRA failed to consider certain factors they claim are mitigating, including their claims that: (1) they lack prior disciplinary history; (2) the violations stem from a single incident (the $350,000 DEER payment); (3) although they did not disclose the $350,000 payment to their customers, they did not actively conceal the DEER payment from anyone; (4) no customers were harmed by their failure to disclose the information; (5) their conduct was not reckless; and (6) they had not ignored warnings from FINRA or another regulator that they were obligated to disclose the information. Applicants additionally claim that FINRA imposed considerably lesser sanctions in *Kunz* and in its settlement agreement with First Merger's chief compliance officer for similar violations.

We find that each of Applicants' arguments is without merit. As we have held consistently in our review of FINRA proceedings, a lack of disciplinary history is not mitigating for sanctions purposes.[61] And the violations do not stem from a single incident because Applicants engaged in a large number of separate transactions over a nine-month period. We find that, contrary to Applicants' claim that they did not conceal the $350,000 payment from anyone, Applicants concealed the payment from the most important persons, their customers, who had no reason to expect that their broker had received a $350,000 payment from an issuer shortly before recommending that issuer's securities. Further, Applicants concealed their misconduct by providing inaccurate and misleading information to FINRA investigators about the timing of the China trip, the receipt of the $350,000, and whether they benefited from the use of those funds.[62] Even if Applicants' assertion about the alleged lack of customer harm is correct

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59 *Id.* at 7 (providing that a principal consideration in determining sanctions is whether respondent "attempted to conceal information from FINRA, or to provide inaccurate or misleading testimony . . . to FINRA").

60 *See id.* at 4 (General Principles Applicable to All Sanctions Determinations, No. 4).

61 *See, e.g.*, *John B. Busacca III*, Exchange Act Release No. 63312, 2010 WL 5092726, at *16 & n.77 (Nov. 12, 2010) (citing *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006); and *Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 WL 3313843, at *6 (Nov. 8, 2006) ("[L]ack of disciplinary history is not mitigating for purposes of sanctions because an associated person should not be rewarded for acting in accordance with his duties as a securities professional.")).

62 *See supra* note 59 and accompanying text.

(a question on which the record is silent), such a finding would not be mitigating.[63] Finally, we reject Applicants' contention that the failure of FINRA or compliance officers at Seaboard or First Merger to advise them of their duty to disclose the $350,000 payment is mitigating. We have held that associated persons are responsible for their own compliance with FINRA Rules and cannot shift that responsibility to another individual or to FINRA.[64]

Applicants' comparisons of their sanctions to sanctions imposed in other cases are unavailing. "[T]he appropriateness of the sanctions imposed depends on the facts and circumstances of the particular case and cannot be determined precisely by comparison with action taken in other cases."[65] Here, FINRA determined Applicants' sanctions based on the presence of the aggravating factors and the absence of mitigating factors with respect to Applicants' specific misconduct.

Separately, Applicants' reliance on the lesser sanctions imposed in a settled proceeding against First Merger's compliance officer is misplaced. The Commission has observed that "comparisons to sanctions in settled cases are inappropriate" because pragmatic considerations "such as the avoidance of time-and-manpower-consuming adversary proceedings" justify imposing lower sanctions in negotiating a settlement.[66] Further, "[l]itigated cases typically present a fuller, more developed record of facts and circumstances for purposes of assessing appropriate sanctions than do settled matters."[67]

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63 *Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 WL 6044123, at *18 & n.137 (Nov. 15, 2013) ("[T]he absence of . . . customer harm is not mitigating, as our public interest analysis focus[es] . . . on the welfare of investors generally.") (citing *Howard Braff*, Exchange Act Release No. 66467, 2012 WL 601003, at *7 & n.25 (Feb. 24, 2012) (internal quotations omitted); *PAZ Sec., Inc.*, Exchange Act Release No. 57656, 2008 WL 1697153, at *5 (Apr. 11, 2008) (holding that applicants' failures to comply with NASD rules "are not mitigated because those failures did not, in themselves, produce a monetary benefit to Applicants or result in injury to the investing public"), *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009); *Coastline Fin., Inc.*, Exchange Act Release No. 41989, 54 SEC 388, 1999 WL 798874, at *5 (Oct. 7, 1999) (rejecting absence of customer harm as a mitigating factor for sanctions)).

64 *See supra* note 35.

65 *Dennis S. Kaminski*, Exchange Act Release No. 65347, 2011 WL 4336702, at *13 (Sept. 16, 2011); *see also Butz v. Glover Livestock Comm'n Co., Inc.*, 411 U.S. 182, 187 (1973) (holding that "[t]he employment of a sanction within the authority of an administrative agency is . . . not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases"); *Geiger v. SEC*, 363 F.3d 481, 488 (D.C. Cir. 2004) (holding that, because the "Commission is not obligated to make its sanctions uniform," court would not compare sanction imposed in case to those imposed in previous case).

66 *Kent M. Houston*, Exchange Act Release No. 71589, 2014 WL 651953, at *7 (Feb, 20, 2014).

67 *Id.*

For the reasons discussed above, we sustain FINRA's imposition of bars in all capacities against both Applicants for their antifraud violations. The bars FINRA imposed on Applicants are remedial because they will protect the investing public by encouraging brokers to disclose all material adverse facts and conflicts of interest when they recommend securities to their customers. The bars also will deter others from selling securities to investors without disclosing all information necessary to avoid misleading those customers regarding the soundness and objectivity of their recommendations. We find the sanctions imposed on Scholander and Harris to be neither excessive nor oppressive.[68]

An appropriate order will issue.[69]

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

Brent J. Fields
Secretary

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[68] Because we find that the sanctions FINRA imposed were appropriately tailored to the violations at issue, we likewise sustain its imposition of costs.

FINRA stated that it would have fined each Applicant $15,000 and suspended them in all capacities for three months for their Rule 3030 violations, but FINRA did not impose these sanctions in light of the bars it imposed for Applicants' antifraud violations. Applicants challenged these findings in their opening brief "to the extent the SEC imposes any sanction" for the Rule 3030 violations. Under Exchange Act Section 19(e)(2), our review of sanctions is limited to whether the sanctions imposed are excessive or oppressive. Because FINRA did not impose sanctions for the Rule 3030 violations, we do not make findings as to whether the sanctions FINRA would have imposed (absent the bars) were excessive or oppressive.

[69] 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. 77492 / March 31, 2016

Admin. Proc. File No. 3-16360

In the Matter of the Applications of

WILLIAM SCHOLANDER
and
TALMAN HARRIS

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

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

ORDERED that the disciplinary action taken by FINRA against William Scholander and Talman Harris be, and it hereby is, sustained.

By the Commission.

Brent J. Fields
Secretary