UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION.

Admin. Proc. File 3-18150

In the matter of the Application of THADDEUS J. NORTH For Review of Disciplinary Action Taken by FINRA	**Reply Brief in Disciplinary Proceeding No. 2012030527503**

Pursuant to the Securities and Exchange Commission (the "Commission") Rules of Practice 152, 154, and 452, applicant Thaddeus J. North ("Mr. North") submits his Reply Brief in support of his Application for Review by the Commission.

Respectfully submitted this 26th day of December 2017.

THADDEUS J. NORTH, BY COUNSEL

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I. INTRODUCTION

Thaddeus J. North ("Mr. North") highlights the following in reply to FINRA's Response Brief. The Hearing Officer's rulings on evidence were not harmless but prejudicial error and so tainted the proceedings that the Hearing and National Adjudicatory Council ("NAC") Panels erred in their conclusions.[1] Professionals Mr. North consulted concluded that all of the electronic files produced to him by Enforcement demonstrate evidence of intentional human intervention, tampering,[2] and alteration.[3] One professional, Frank Huber, determined that Smarsh, Inc. ("Smarsh") does not own, operate or control any of the necessary equipment to have produced the files and reports attributed to Smarsh, which FINRA used in its proceedings against Mr. North.[4] Mr. Huber also concluded that instructions Smarsh gave users to change settings on communication devices redirected business and personal communications in real time to a private network accessed by FINRA, meaning that FINRA altered the data.[5] Neither FINRA nor Smarsh have denied the condition of the production files, nor have they produced a credible third party witness to demonstrate the source and authenticity of the Email in the production files or the compliance reports allegedly prepared by Smarsh ("Smarsh Reports").[6] Instead, Enforcement's circuitous arguments exemplify how it penalizes individuals who act in recognition of the importance of enforcing firms' written supervisory procedures ("WSP") by

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[1] Mr. North's Opening Brief ("Appl. Br.") at 2–3, 10–13, 16–26.
[2] *Id.* at 4–5, 13, 15, 19–21. *See, e.g.*, Record ("R") at 001271 (Enforcement Exhibit CX-2).
[3] FINRA Examiner McKennedy testified that he "fixed" the compliance reports to correct a leap year issue. Appl. Br. at 12–13, 21–22, 24–25.
[4] *Id.* at 4–5 n.9–14.
[5] *Id.* at 4–7, 14–15. According to the Electronic Communications Privacy Act of 1986, 18 U.S.C. §§ 2510–2522 (2015), the instructions were an unlawful device of interception causing all business *and personal* messaging to be delivered to FINRA as sent and received by users.
[6] *Id.* at 3.

stepping in to perform tasks, when and as a need is observed,[7] but then by FINRA's proxy are held solely responsible for the failure of others, including supervisors or principals with the express duties to perform the tasks. To wit:

> North stated "... if he [Schloth] was not reviewing emails, then I would do it to be a good person and get in there and make sure it's done." ... it "made sense" that he "help out" with the electronic communication review for Ocean Cross.
>
> North stated that he "knew that [Schloth] wasn't doing it in the beginning because we were so busy doing all sorts of other stuff, and he was trying to get business in the door, that ... if [Schloth] was not doing it, then I would step in and do it." The Commission has made it abundantly clear that supervisors must act decisively when an indication of irregularity is brought to their attention. North's limited actions were insufficient to comply with the WSPs he admittedly put in place and was in charge of Enforcing. Enforcement' Resp. Br. at 21 (internal citations omitted).

What Enforcement intends is that no matter what Mr. North did to review Email it would never be enough after he observed Schloth's deficiency. Enforcement's flawed reasoning means that chief compliance officers who act with expediency by voluntarily performing a task assigned by the firm WSP to another principal, supervisor, or employee, are thereby required to take over that responsibility entirely and assume full liability for the failures of others that could not have been foreseen, notwithstanding the compliance officer's qualifications and other duties.

Enforcement's flawed reasoning, taken to its logical extreme, would make compliance impossible in this case: after Schloth's failure to review Email daily, Mr. North could never be free from or exonerated for Schloth's failure to review Email daily. After Schloth missed any days of Email review, because of FINRA's *ex post facto* proxy, no matter the rules or what Mr. North did, whether he did nothing or whether he acted with expediency to ensure Email was being reviewed, Mr. North would always be guilty for Email not being reviewed daily.

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[7] *Id.* at 8–9.

II. ARGUMENT

A. Enforcement's flawed reasoning caused it to improperly overstep its authority.

1. There is no Commission or FINRA rule that requires daily Email review.

There is no Commission or FINRA rule or advisory notice that requires daily Email review[8] or suggests FINRA should use a term in a WSP to reach such an extreme and onerous interpretation and application of Commission and FINRA rules. In this case, Enforcement wrongly assumed the role of enforcing the details of its member firm's WSP. Because WSPs can be varied from one firm to another, FINRA's over-reaching and ad hoc approach to enforcement will lead to inconsistency and confusion as to how and when compliance with Commission or FINRA rules is possible.

2. The WSP does not designate Mr. North for Email review and Mr. North was not a supervisor at Ocean Cross.

The WSP clearly designated the Ocean Cross President, Schloth, (and the Municipal Securities principal) to review Email.[9] Further, there is no document from Ocean Cross management appointing or designating Mr. North as a supervisor or principal responsible for Email review that contradicts the clear language of the WSP. The firm submitted its WSP for FINRA approval with Ocean Cross' application to commence operations as a FINRA firm; therefore, in preparing the WSP, it was at management's direction that Mr. North did not designate himself for Email review.[10] And for the same practical and rational reasons he did not supervise any employees. The firm was in its first months of operation; Mr. North had substantial compliance duties to attend to during transition, including the start up activities for

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[8] Appl. Br. at 30 n.147–48.
[9] *Id.* at 27–30.
[10] *Id.* at 8, 27–28. Per FINRA's requirements Ocean Cross' management submitted the WSP to FINRA with the firm's application for approval to do business.

Ocean Cross while closing the Southridge Investment Group LLC ("Southridge") operations.

Not to be lost in the discussion is that a WSP can be changed and modified anytime a firm recognizes that terms or protocols are no longer viable or reasonable due to changing circumstances and industry practices. Mr. North could have changed the terms in the WSP to a weekly or other interval for Email review and that change would have been reasonable and lawful under Commission and FINRA rules.[11] Further, because databases normally allow users to define search criteria to encompass almost any time period so that no Email is overlooked, daily Email review is unnecessary and may actually be counter-productive or waste resources.

3. Mr. North's actions complied with Commission and FINRA rules.

When Mr. North stepped in to review Email to ensure that the firm was in substantial compliance with its WSP, the firm was already in compliance with the Commission and FINRA rules. Further, there was no criticism of the WSP and no dispute that overall the WSP provided reasonable guidance for the firm and compliance with the Commission and FINRA rules. There is no dispute that Email was reviewed, as Mr. North testified, or that he used random sampling and key word search criteria in his reviews.

4. FINRA imposed liability on Mr. North by FINRA's proxy.

The Catch-22 is that after-the-fact of observing that Schloth had not reviewed Email daily, Mr. North could never show that Email was reviewed daily. FINRA issued Rule 8210 letters that only inquired about Mr. North's actions. FINRA never inquired about nor did it request any Email compliance records from Smarsh relating to Schloth or the Municipal Securities principal, both of whom had responsibility to review Email.[12] FINRA Examiner

[11] *Id.* at 30.
[12] *Id.* at 27–29. *See also* R. at 001279 (Enforcement's Exhibit CX-3: Ocean Cross' letter in response to Rule 8210 request) and R. at 001339 (Respondent's Exhibit RX-12: WSP Excerpt).

McKennedy's hearsay statement that Mr. North [only] reviewed Email is likely due to his confusion because FINRA was examining both Southridge and Ocean Cross simultaneously and because Mr. North was primarily responsible for Email review at Southridge.[13]

B. **Mr. North's expert determined that Smarsh does not own, operate or control registered server equipment.**

According to one professional consulted by Mr. North, *e.g.*, Frank Huber, the registries of the American Registry of Internet Numbers ("ARIN") and the Internet Assigned Numbers Authority ("IANA") have no record of Smarsh owning, operating, or controlling any servers with which to host Email, archive Email, or support the alleged Smarsh Management Console ("SMC") from which Smarsh Reports allegedly came.[14] Because Smarsh does not own, operate or control any of the necessary equipment, Smarsh did not have the intent or capacity to archive Email or support compliance actions on an SMC, and Smarsh could not have produced the Smarsh Reports. Smarsh witness Jimmy Douglas could not truthfully represent that Smarsh hosted Email services for seamless archiving for Ocean Cross as he was solicited by Enforcement to do.[15] Smarsh not owning, controlling, or operating the necessary equipment explains why Mr. Douglas did not know where Smarsh servers are located and why Smarsh could not produce, and why FINRA resisted producing, the underlying data supporting the Smarsh Reports. Because his background is in sales, Mr. Douglas' lack of technical expertise explains why he was not qualified to testify for laying foundation for the admission of the Smarsh Reports and why he did not know that server or like administrative event logs ("server / event logs") recorded users' access to data and can be printed in line item form and used to

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[13] Appl. Br. at 28 n.128.
[14] *Id.* at 16 n.10. *See* Exhibits 1-5 attached to Mr. North's Motion and Brief in Support of Admission of Additional Evidence to Supplement the Record in Disciplinary Proceeding No. 2012030527503. Appl. Br. at 16 n.9.
[15] *Id.* at 23–24 n.110–116.

prepare the Smarsh Reports as a spreadsheet summary of the server / event logs.

No third party professional would be able to testify about the preparation of the Smarsh Reports without access to the server or SMC equipment or server / event logs for comparison to the Smarsh Reports to ascertain the accuracy of the reports. Therefore, the Hearing Officer's refusal to require production of the underlying data for the Smarsh Reports was not harmless error—it effectively prevented Mr. North or any professional he chose from validating the source and contents of the Smarsh Reports by having the necessary source material for comparison.

The Hearing Officer previously deemed the Email and expert testimony about it irrelevant to prevent testimony about the causes of the anomalies and false positives in the Email, which called into question the reliability of Smarsh's archiving and compliance services.[16] Therefore, when the Hearing Officer admitted the Smarsh Reports without requiring the production of the underlying data, she prejudiced Mr. North's ability to challenge the source, authenticity, accuracy, and reliability of the contents of the Email and Smarsh Reports. Combined with the rulings about the irrelevance of the Email, admitting the Smarsh Reports without the underlying data was not harmless error; the rulings prevented Mr. North from presenting his defense on every front while admitting only evidence to discredit him.[17]

1. The Smarsh Reports were produced on non-Y2K compliant resources.

After the year 1999, Smarsh could not legally own and operate non-Y2K compliant resources.[18] Mr. North urges that because Smarsh should not own or operate non-Y2K compliant resources and FINRA Examiner McKennedy could access and change the Smarsh Reports to fix the leap year issue, it means that FINRA employees had access to the non-Y2K compliant

[16] Appl. Br. at 6, 11, 15–16, 20, 26.
[17] *Id.* at 19–26.
[18] Y2K Act, 15 U.S.C. §§ 6601–6617 (1999).

resources on which the Smarsh Reports were created. Further, consistent with Mr. Huber's conclusions, it means that the Email was intercepted and redirected to FINRA and that the alleged archive and "compliance" platform or SMC was under FINRA's control.[19] The fact that Examiner McKennedy could change the reports, means that Enforcement could make up the alleged Smarsh Reports to reflect anything contrary to Mr. North's testimony and responses to Rule 8210 inquiries, i.e., that he reviewed Email to make up for Schloth's failures.

2. But for the errors in the admission of evidence, the outcome of this matter would have been different.

According to FINRA Rule 9251(g) and the application of the harmless error doctrine, it is prejudicial error, not harmless error, when the admission or non-admission of evidence would have changed the outcome of the proceedings.[20] Individually and collectively, the errors made by the Hearing Officer and NAC Subcommittee were prejudicial, not harmless.[21] But for those errors the outcome before the Hearing and NAC Panels would have been different. Enforcement chides Mr. North for his persistent objections to evidence, founded on principles contained in the Federal Rules of Evidence,[22] and accuses him of not marshaling the evidence. Yet, when considering the findings of the professionals Mr. North consulted, he had to object to the deficiencies in the production files and Smarsh Reports, deceptive witness statements, and hearing evidence that was different from his experience and contrary to the record.[23]

The Smarsh Reports failed admissibility requirements according to the Federal Rules of Evidence, which would require FINRA, as proponent of the evidence, to produce the underlying data for the reports and a qualified witnesses to testify about the sources of information making

[19] Appl. Br. at 14–15, 24–25.
[20] *Id.* at 18–19.
[21] *Id.* at 17–26.
[22] *Id.* at 21–26.
[23] *Id.* at 9–10, 33–38.

up the reports and how each report was prepared from the source data, meaning the server / event logs for the Email archive or SMC or both.[24] Neither Smarsh nor FINRA produced either. Instead, Mr. Douglas's letter and subsequent testimony falsely conveyed the appearance of archiving and compliance support services that Smarsh could not deliver.[25] Mr. Douglas did not prepare the Smarsh Reports and did not recognize that the reports, as summaries in spread sheet form, were necessarily prepared from server / event logs that automatically record or log the details of users' access to stored data. Mr. Douglas also could not explain how an Email that appears to be personal Google Gmail would be in the production files since Smarsh was not archiving Google Gmail.[26] Five months later, FINRA Examiner McKennedy admitted that he fixed the Smarsh Reports by accessing non-Y2K compliant resources Smarsh could not lawfully own and operate, but that were accessible to FINRA employees.[27]

Considering that Smarsh does not own, operate, or control the necessary equipment to produce the Smarsh Reports, that the reports were produced using non-Y2K resources, that Smarsh witness Douglas' testimony was not truthful, but instead gave insufficient, improper foundation for admission of the Smarsh Reports, that no server / event logs were produced to validate the reports, and that the reports were changed by FINRA employees, it is clear why authentication and proper foundation are essential for the admission of evidence like the Smarsh Reports and why the Hearing Officer's error was not harmless. Due to the dubious sources of the Smarsh Reports, it was prejudicial error, not harmless error, to admit them.

The Hearing and NAC Panels dismissed Mr. North's candor as lacking credibility even though he did not hide the fact that *he* did not review Email daily for rational and mitigating

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[24] *Id.* at 22–26 n.102–110.
[25] *Id.* at 11–12.
[26] *Id.* at 12–13.
[27] *Id.* at 13, 24–25.

reasons already explained. The Smarsh Reports were designed to discredit Mr. North's frank testimony and cause him to appear untruthful.[28] The reports were designed to persuade the Hearing and NAC Panels to discredit Mr. North's testimony, his proffered evidence, and his defenses entirely, while ignoring Enforcement's misconduct and over-reaching, and the fact that Commission and FINRA rules do not require daily Email review.

III. CONCLUSION

FINRA does not deny the condition of the production files, that it used altered Email to support its complaint, and that when challenged, it argued that the Email was irrelevant because its condition could not be explained by legitimate archiving practices.[29] FINRA ignored that Schloth and the Municipal Securities principal were responsible for Email review, not Mr. North. The admitted use of non-Y2K compliant resources identifies FINRA as the author of the Smarsh Reports, undermining the credibility and admissibility of the reports as proof of non-compliance.

Mr. Huber concluded that FINRA procured Smarsh to help intercept brokers' Email and redirect it to FINRA in real time for processing to suggest securities law violations and to create compliance records attributed to Smarsh. By illegally intercepting Ocean Cross Email, FINRA interfered with the firm's operations, sabotaged compliance, and deprived Mr. North of material evidence of his compliance. FINRA's use of tainted evidence was a fraud on the administrative process to secure a meritless prosecution.[30] The evidentiary errors made in the FINRA proceedings are not harmless, but irreparably altered the outcome of the case.

Mr. North contends that all orders in this matter should be reversed and vacated, and any adverse record relating to these proceedings expunged from his record.

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[28] *Id.* at 22.
[29] *Id.* at 9–12.
[30] *Id.* at 33–38.

Respectfully submitted this 26th day of December 2017.

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CERTIFICATE OF SERVICE

I hereby certify that on the 26th day of December 2017, a copy of Thaddeus J. North's Reply Brief in this matter was sent by USPS mail to the Commission and to FINRA at:

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