BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. William James Potter Glen Ridge, N.J., Respondent.	Decision Complaint No. 2017052871401 Dated: May 27, 2021

Extended Hearing Panel found that respondent engaged in unethical conduct in violation of FINRA Rule 2010. Held, findings of violation reversed, sanctions vacated, and complaint dismissed.

Appearances

For the Complainant: Megan P. Davis, Esq., Kay Lackey, Esq., Jessica Brach, Esq., Kevin Hartzell, Esq., Payne Templeton, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Mark J. Astarita, Esq.

Decision

William James Potter appeals an August 7, 2019 Extended Hearing Panel ("Hearing Panel") decision. The Hearing Panel found that Potter, while acting as a third party to a real estate refinancing transaction between two other parties, violated FINRA Rule 2010 by (1) converting a portion of funds belonging to one party to the transaction and (2) misusing another portion of the funds and engaging in other unethical conduct. For these violations, the Hearing Panel twice barred Potter and ordered him to pay $250,000 in restitution. After reviewing the record de novo, we reverse the Hearing Panel's findings of violation, vacate the sanctions it imposed, and dismiss the complaint.

I. Introduction

Potter entered the securities industry in the mid-1970s and registered with FINRA in 1991. In 2004, Potter and several others formed Meredith Financial Group ("Meredith Financial") as a holding company. Meredith Financial acquired a FINRA member broker-dealer, Robert R. Meredith & Co. ("Meredith B-D"), and established an investment advisor, Meredith Portfolio Management, Inc. In 2006, Potter registered with Meredith B-D as a general securities representative and general securities principal. During the relevant period, from 2013 through 2014, Potter served as president and chairman of Meredith Financial, and president, chairman, and chief compliance officer of Meredith B-D.[1]

This matter arises from a failed $75 million real estate refinancing transaction between a U.S.-based real estate developer (the "Developer") and a Germany-based entity (the "Financier"). This was not a securities transaction, and neither the Developer nor the Financier was Potter's customer. Potter's relationships with the Developer and the Financier were contractual.

In 2013, the Developer hired the Financier to settle its defaulted mortgage debt on property it owned in Chicago. The Developer agreed to pay the Financier in advance a refundable $2 million "retainer." The Financier assured the Developer it would return the retainer if it failed to settle the debt. As security for the retainer, the Financier agreed to provide to the Developer a bond power and Depository Trust Company ("DTC") codes for $3 million of a medium-term note issued by a petroleum shipping company (the "Shipping Note").[2]

The Financier's agent, a Switzerland-based financial advisor (the "Swiss Advisor"), asked Meredith Financial to assist with the exchange of the retainer and security between the parties. At the time, the Swiss Advisor owed Meredith Financial more than $250,000 from past business dealings. The Swiss Advisor told Potter that it would use its compensation from the refinancing transaction to pay some of that debt. Potter agreed to help with the exchange of the retainer and security between the Developer and the Financier.

The exchange of the retainer and security occurred in March 2013. Meredith Financial received $2 million from the Developer and received DTC codes from the Financier. Meredith Financial then passed each to the other party (the Financier provided the bond power directly to the Developer). During the exchange, the Swiss Advisor told Potter to keep $250,000 of the retainer as partial payment of its debt to Meredith Financial, and to wire the remaining $1.75 million to an entity affiliated with the Financier (the "Financier's Affiliate") and to the Swiss

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[1] Potter's FINRA registration terminated in August 2016. Meredith B-D's FINRA membership terminated in 2018.

[2] A bond power is a separate legal form that authorizes the transfer of ownership of a registered bond from one party to another, without endorsing the actual bond certificate. *Bond Power*, *Investopedia.com*, https://www.investopedia.com/terms/b/bond-power.asp (last visited April 26, 2021).

Advisor. Potter did as the Swiss Advisor instructed. The Developer received the DTC codes and bond power, and a few days later, the Financier acknowledged receipt of the retainer.

The Financier was supposed to settle the debt by April 1, 2013, but it could not reach an agreement with the mortgage holder (the "Lender"). Three weeks later, the Developer's property was sold at auction. The Developer allowed the Financier to continue negotiating with the Lender for nine more months in the hope the Financier could buy back the property from the Lender. During that time, the bond power for the Shipping Note expired.

In early 2014, the Developer learned that the bond power for the Shipping Note was not effective and demanded its retainer back. The Financier refused, claiming it had fulfilled its contractual obligations. The Developer was unable to sell the Shipping Note using the bond power and DTC codes, and it never recovered its $2 million.

In August 2018, FINRA's Department of Enforcement ("Enforcement") filed a two-cause complaint against Potter alleging that he (1) converted about $25,000 of the retainer and (2) misused the rest of the retainer and engaged in other unethical conduct, in violation of FINRA Rule 2010. The Hearing Panel found Potter liable under both causes of action. The Hearing Panel barred Potter under each cause and ordered him to pay $250,000 in restitution. Potter appealed the Hearing Panel's decision.

II. Facts

A. The Developer Defaults on Its Mortgage and the Lender Forecloses

In the 1990s, the Developer bought property in Chicago on which it planned to construct a large hotel and other commercial and residential buildings. PG oversaw the project for the Developer. PG had more than 40 years of experience in real estate development and had worked on more than 80 projects across the country during that time. The Developer's owners were PG's husband, KN; PG's and KN's children's trusts; and KS and CS, a married couple who were close friends with PG and KN. KN helped PG manage the Developer's day-to-day affairs. KS was not actively involved in managing the company, but he was a successful entrepreneur who had started and operated several other businesses.

In February 2008, the Developer refinanced its debt on the property through the Lender. The Developer executed a $37 million promissory note secured by a mortgage. Just before closing on the refinancing, the Lender forced several significant concessions from the Developer, including a higher interest rate and a personal guarantee from PG and KN. In 2009, the Developer defaulted, and the Lender foreclosed.

Over the next four years, the Developer and Lender engaged in litigation. In late 2009, the state court overseeing the foreclosure ordered the Developer's property sold at a judicial auction. The Developer responded by filing for Chapter 11 bankruptcy in federal court, which stayed the state court proceeding. The Developer and Lender then litigated the bankruptcy case for another two years until April 2012, when the bankruptcy court dismissed the Developer's petition and lifted the stay on the foreclosure proceeding. In August 2012, the state court entered

judgement in favor of the Lender and ordered the Developer's property sold at auction. Just days before the auction, however, the Developer filed a second petition for Chapter 11 bankruptcy, once again staying the state court proceeding. Throughout this period, the Developer was unable to find another lender to refinance its defaulted debt.

B. The Developer Is Introduced to the Financier

While the Developer's second bankruptcy petition was pending, a mortgage broker in Chicago referred it to the Financier. The Financier was based in Frankfurt, Germany, and its principal, BV, was a citizen of the United Kingdom who lived in London. In October 2012, PG, the Developer's attorney, and several others met with the Financier in Chicago. BV introduced the Developer to his associate, WP, who had an office in Chicago and would serve as the Financier's local representative. BV also introduced DS. At the hearing, PG described DS as the Financier's "deep pockets." She said the Financier presented DS as "a man of extraordinary wealth" who owned "very large tracts of land in Albania and gold and money and stocks and bonds and everything else."

PG testified that BV proposed a "grand funding program" under which the Financier would provide around $400 million to refinance the Developer's existing debt, which by then had grown to more than $70 million, and also fund completion of the rest of the project. The Financier showed the Developer a bond power for a $2.1 billion note issued by a major American company and claimed to own other assets it could use to fund the transaction.

After the meeting, the Developer conducted due diligence on the Financier and was satisfied with the results. PG testified that the Financier had a "presence you could track. There was an office in the United States. They had a website . . . people associated with it." PG said the Developer researched DS, the Financier's "deep pockets," and found "information about him that seemed to back up their claims" about his wealth. As for BV, however, PG said, "There was not very much on [BV], if I recall." When pressed for details about the Developer's research into BV's background, PG said she could not remember whether anyone ran a credit check or a background search on him. The Developer later learned that BV had served time in an English prison for fraud during the 1990s.

Ultimately, the Developer decided against moving forward with the "grand funding program" because the Financier demanded advance payment of its $5 million fee. According to PG, the Developer "couldn't do that, and we weren't going to do that." PG said the Developer put the Financier "kind of on the side burner" while it continued searching for another lender to refinance its debt.

C. The Developer Agrees to Pay a $2 Million Retainer to the Financier and Accept a Bond Power and DTC Codes as Security

By January 2013, the Developer was running out of time. It had not found another lender to refinance its debt, and the bankruptcy court had dismissed its second bankruptcy petition, clearing the way for the foreclosure proceeding. The Developer knew that a judicial auction of its property was only weeks away.

Around this time, the Financier came back with a scaled-down proposal that would require an advance payment of a more affordable, and fully refundable, $2 million retainer. The Financier said it would settle the Developer's debt either by renegotiating its terms or paying off the balance and becoming the new mortgagee. If the Financier succeeded, it would keep the retainer and receive an additional $3 million fee from the Developer. If it failed, it would return the retainer to the Developer.

According to PG's testimony, BV disclosed that the Financier intended to spend the retainer immediately upon receipt, and he specifically disclosed that the Financier intended to pay part of the retainer to the Swiss Advisor. BV told PG that the Financier owned $75 million of the Shipping Note and had hired the Swiss Advisor and its principal, RD, to broker the sale of the note and raise the cash the Financier needed for settlement. PG testified that she and BV had "lots of discussions about what would happen with the money, and that it was going to be . . . somehow used in this process to cash in the bonds for [the Swiss Advisor]."[3]

The Developer demanded security from the Financier to ensure the retainer's return in the event the Financier was unable to settle the debt. The Financier offered a bond power and DTC codes for $3 million of the Shipping Note (the same note it was going to sell to raise the cash to settle the debt). PG testified that she consulted with the Developer's banker and broker-dealer, and they assured her that a bond power and DTC codes would be sufficient to sell the Shipping Note. PG said the Developer also confirmed the marketability of the note. According to PG, "we had to look at what exactly was this bond . . . what was their collateral, and so we did determine that [the issuer] had ships that they owned, . . . and that the ships were—you can follow where the ships were going. So we did an investigation."

The Developer wanted the retainer to remain in the United States until the Financier provided the security. PG testified that the Developer was familiar with escrow agents and had used them before when it was "appropriate," but it did not believe one was necessary here. PG testified that the Developer proposed using its law firm to facilitate the exchange of the retainer and security, and the Financier suggested Meredith Financial. PG said the Developer had never heard of Meredith Financial, but after conducting diligence, the Developer was satisfied the Financier "had offered an alternative that was acceptable, a financial institution that had credibility in our opinion, in our due diligence."

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[3] PG testified that the Developer conducted diligence on RD before entering into the refinancing transaction.

D. Potter Agrees to Assist with the Exchange of the Retainer and Security

According to Potter, in late February 2013, the Swiss Advisor's principal, RD, telephoned and asked if Meredith Financial would assist with the exchange of the retainer and security. Potter explained that he knew RD because he previously had done business with him and his company. Potter described RD as "a trust officer." He said he had known him for several years, that their relationship was "professional," and that he "didn't socialize with" RD. Potter testified that, at the time, he had never met BV or done business with the Financier.

Potter said RD told him that Meredith Financial's involvement in the transaction would be limited to receiving money from the Developer, DTC codes from the Financier, and passing each to the other side. Potter said he understood his role was to provide a "perception of trust" because "they wanted somebody to make sure that they held the [DTC] codes until the money was passed, and passed the codes and the money roughly at the time same time. So there was probably an independence factor[.]"

Potter testified that he did not expect Meredith Financial to be compensated directly for its role in the transaction, but he still expected the company to benefit financially. At the time, the Swiss Advisor owed Meredith Financial more than $250,000 from their past dealings.[4] Potter said the Swiss Advisor "indicated that [it] expected to receive something, and that would help [the Swiss Advisor] make the payment they owed us." Potter said the Swiss Advisor did not specify when Meredith Financial would receive the payment or the amount, and that he agreed to help with the exchange of the retainer and security primarily as a favor to RD.

PG spoke to Potter one time, by telephone, before the Developer paid the $2 million retainer. At the time, PG knew that Meredith Financial had done business with RD and the Swiss Advisor before, but she did not know that the Swiss Advisor owed money to Meredith Financial, or that Meredith Financial expected the Swiss Advisor to use its fee from the refinancing transaction to pay some of that debt. Potter testified that PG did not ask him about his past dealings with RD and the Swiss Advisor, or whether he expected to receive any benefit from the transaction.

E. The Financier and the Developer's Attorney Draft Agreements Governing the Exchange of the Retainer and the Security

In early March 2013, BV and the Developer's attorney created two agreements governing the exchange of the retainer and security—the "Consulting Agreement" and the "Agreement of Release."[5] BV created the Consulting Agreement and emailed it to the Developer's attorney. The Consulting Agreement was between the Financier and the Developer only. Meredith Financial was not a party to it.

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[4] Enforcement did not dispute the validity of this debt or its amount.

[5] A third agreement governing the refinancing transaction also was created but it is not in the record.

On March 7, 2013, after speaking with Potter and RD by telephone, the Developer's attorney created the Agreement of Release. The Agreement of Release was four sentences long, and it was between the Financier, the Developer, and Meredith Financial. In an email to BV that day, the Developer's attorney wrote that she had "an informative and reassuring conversation" with Potter and RD that "helped clarify the instructions given to Meredith [Financial]." The Developer's attorney wrote that, "pursuant to this conversation," she had revised a paragraph of the Consulting Agreement "regarding the process for the release and the DTC codes" and "added an addendum agreement [i.e., the Agreement of Release] clarifying the release of the retainer fee and DTC codes/bond power."

Under the Consulting Agreement and Agreement of Release (collectively, the "Agreement"), the exchange of the retainer and security was supposed to occur as follows.[6] On March 8, 2013, the Developer would wire $2 million to Meredith Financial's checking account at a New York bank. On March 11, 2013, the Financier would provide to the Developer a bond power and the "first six" DTC codes for the Shipping Note, and it would provide to Meredith Financial the "remaining six" DTC codes. Once the Financier provided the bond power and the twelve DTC codes (six each to the Developer and Meredith Financial), it was entitled to receive the retainer. The Financier had until April 1, 2013, to settle the Developer's debt. If the Financier settled the debt by the deadline, the $2 million retainer would be credited to the Financier's $5 million fee for the transaction. If the Financier failed to settle the debt, the Financier either would return $2 million to the Developer or instruct Meredith Financial to release the "remaining six" DTC codes to the Developer.[7]

F. The Developer and the Financier Exchange the Retainer and Security

The Developer and Financier exchanged the retainer and security in mid-March 2013, but the exchange did not go as planned. On March 9, 2013, the agreements were executed, as scheduled, but the Developer was unable to wire $2 million to Meredith Financial.

On March 11, 2013, RD emailed all twelve DTC codes to Potter and instructed him to keep $250,000 of the retainer as payment for the Swiss Advisor's debt.[8] Attached to RD's email was a letter from BV to RD dated March 8, 2013. In the letter, BV asked the Swiss Advisor to receive the retainer on the Financier's behalf.

On March 12, 2013, the Developer's attorney initiated the $2 million wire transfer to Meredith Financial's checking account. At the time, the Developer did not have $2 million, so KS agreed to put up his personal funds.

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[6] The Hearing Panel found that the Consulting Agreement and the Agreement of Release were one integrated agreement. Neither party challenges this finding on appeal.

[7] This is the Hearing Panel's interpretation of the Agreement, which both parties have adopted for purposes of this appeal.

[8] Meredith Financial was supposed to receive only six DTC codes.

Immediately after the Developer's attorney initiated the wire, PG began emailing Potter asking for the DTC codes so the Developer's broker-dealer could "block" the Shipping Note. PG testified that "blocking" the note was her "terminology for making sure that we can secure [the note], and that no one else can take our collateral, that it was—we can take it when we needed to, as we were entitled to it, and no one else could touch it."

Potter replied that he had received the DTC codes from the Swiss Advisor with instructions to release them as soon as Meredith Financial received the wire.

PG then asked Potter whether he would assist the Developer's broker-dealer with blocking the Shipping Note.

Potter responded, "[I]t is probably best that [RD] or one of his colleagues handles that discussion," and that he would "release the codes to [PG] and [the Developer's attorney] once the wire has been credited to the Meredith [Financial] account."

PG replied, "We have asked our private banker to assist us with the codes and 'blocking' for security, if you could assist in introducing him to the process, we appreciate it."

Potter responded that he would "coordinate the process and [the private banker's] understanding with our Swiss colleagues."

The next day, March 13, 2013, BV emailed the Developer's attorney objecting to the Developer's intent to block the Shipping Note. BV wrote that, by blocking the note, the Developer would be "effectively buying the [Shipping Note]—it is not the same as placing a lien/charge on the asset as collateral." BV further wrote that blocking the note required all twelve DTC codes, but the Developer was entitled only to the "first six" codes at that time. BV wrote that if the Developer provided the "details of its [brokerage] account," he would "arrange for a 'potential blocking' notification to be issued to them."[9]

In the same email, BV objected to the Developer's communications with Potter. BV wrote that Meredith Financial's role was "solely to facilitate the receipt of the Retainer and if necessary its return or the release of the last 6 DTC Access Codes. Accordingly, any inquiries should be sent to [BV or WP] or [the Swiss Advisor] and not to Meredith."

Later that afternoon, Potter emailed PG and the Developer's attorney confirming receipt of the $2 million wire and providing all twelve DTC codes for the Shipping Note.[10] Attached to

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[9] The record does not explain what a "potential blocking notification" is, or whether the Developer took BV up on his offer to provide one.

[10] Potter was not supposed to provide any DTC codes to the Developer at that time. The Developer was entitled only to the "first six" DTC codes, which the Financier was supposed to provide. Potter's error was in the Developer's favor, however, as the Developer immediately had the bond power and all twelve DTC codes it needed to sell the Shipping Note.

Potter's email was the March 8 letter from BV to RD in which BV asked the Swiss Advisor to receive the retainer from Meredith Financial on the Financier's behalf.

When PG was asked at the hearing whether the Developer did anything at the time to verify that the DTC codes it received from the Financier "were proper, adequate, functional," PG responded, "I called [the Developer's private banker] and a couple of other people to find out because I had no idea how that worked. So I called other people to ask if it was correct."

On March 12 and 13, 2013, while Meredith Financial was in possession of the retainer, the balance in the company's checking account dropped below $2 million by about $25,000 following several large withdrawals.

On March 14, 2013, the final condition for the retainer's release was satisfied when BV emailed the bond power and "first six" DTC codes to the Developer's attorney. The bond power was dated and notarized March 8, 2013, and provided that it would "have a validity of three [] months from the date herein stated," i.e., June 8, 2013. PG testified that the Developer's attorney reviewed the bond power on receipt and was satisfied it was sufficient. PG said the Developer did not ask Potter to review the bond power, and Potter testified he did not do so.

On March 15, 2013, the Swiss Advisor emailed Potter wiring instructions for the retainer. The Swiss Advisor directed Potter to wire $1.7 million of the retainer to the London bank account of the Financier's Affiliate, and $50,000 to the Swiss Advisor's bank account. Potter wired the money that day, withholding the balance as payment for the Swiss Advisor's debt to Meredith Financial, as RD had instructed. BV emailed PG and KS on March 18, 2013, and confirmed the Financier's receipt of the retainer by stating that he had begun negotiations with the Lender and would keep them apprised of any developments.

Around this time, BV suggested that the Developer create a new entity to conceal PG's and KN's continued involvement in the redevelopment project. The Financier planned to offer the Lender an ownership stake in the project as partial payment for the Developer's debt. BV was concerned that, due to the extended foreclosure and bankruptcy litigations, the Lender would not accept an interest in the project if it knew PG and KN were involved in it. The Developer, through its attorney, created an entity in which neither PG nor KN had a direct ownership interest. The Developer then assigned its assets to the new entity. The Financier negotiated with the Lender on behalf of the new entity so the Lender would not know PG and KN were involved.

G. The Financier Fails to Settle the Developer's Debt and the Property Is Auctioned

By late March 2013, the Financier had not settled the Developer's debt, and the Developer agreed to extend the April 1 deadline. PG testified that, on March 30, 2013, she and BV spoke by telephone, and BV told her that a deal was "very close," but he needed more time.

On April 5, 2013, the Developer's attorney in the foreclosure proceeding emailed PG asking if he should contact the Financier's attorney about the transaction. PG forwarded the email to Potter. Potter forwarded PG's email to BV without comment. BV responded to Potter that he had spoken with the Lender's chief investment officer and was hopeful the Lender would

issue a letter that day confirming the deal. BV continued, "The animosity between [the Lender] & [PG] is a real problem and we would not have a deal if the property was to be developed with [PG & KN] involved—absolutely categorically not. Once again, my apologies for the behaviour of the [Developer's] group."

Later that afternoon, PG emailed BV thanking him for the update he had provided earlier that day by telephone. PG continued, "It has been a difficult and animus [sic] relationship [with the Lender] and exacerbated by extended litigation. It will be a relief to have that behind us and move forward with our excellent team and partners."

On April 19, 2013, three days before the scheduled judicial auction, BV informed the Developer that the deal with the Lender was off and that the Financier would not be bidding on the property at the auction. In a letter delivered by the Financier's local representative, WP, BV wrote that the Financier had the funds needed for settlement but would wait until after the auction to make a deal with the Lender. PG then emailed BV and WP asking for a "session to discuss strategic decisions and [] options." WP responded that BV was travelling and would contact PG the next day. PG emailed Potter and asked whether BV was on the way to the United States. Potter replied that BV was in London, and that BV would email PG that weekend.

Two days later, on April 21, 2013, the day before the judicial auction, BV emailed PG, KS, and CS about the breakdown in the negotiations and the Financier's plan going forward. BV wrote, "Be assured we have developed a strategy that enables us to control the outcome of the auction and/or the post auction situation." BV wrote that he believed the Lender's decision to back out of the earlier deal "was the result of inappropriate contact with [the Lender] that caused [the Lender] to question our independence [from the Developer] at a critical time." BV wrote that he could not share the Financier's plan with the Developer because he feared the Developer would share it with others.

PG testified that she spoke with BV later that day, and BV assured her that, despite what he wrote in his letter, the Financier's attorney was going to bid on the property at the auction. At the auction the next day, however, the Financier's attorney did not bid on the property, and the Lender bought it for $65 million, leaving a deficiency of about $20 million. Because PG and KN had guaranteed the note, they were personally liable for about $13 million of the deficiency.

H. The Developer Allows the Financier to Continue Negotiating with the Lender Past the Bond Power's Expiration Date

Following the auction, the Developer did not demand that the Financier return the retainer. Instead, the Developer urged the Financier to buy back the defaulted note from the Lender before the court confirmed the sale. The hearing on the Lender's motion to confirm the sale initially was scheduled for May 7, 2013, but it was pushed back to June 6, 2013, after the Developer objected to the Lender's motion to confirm.

On May 9, 2013, KS emailed BV and encouraged him to pay the $85 million balance due on the note before the court confirmed the sale. KS wrote that the Developer's successor entity

had a legal right to buy the property from the Lender before the confirmation, which would eliminate PG's and KN's personal liability for the $13 million deficiency.

In a series of emails that BV and KS later exchanged, however, BV told KS that the Financier could not pay off the debt because the Lender would not negotiate until the judicial sale had been confirmed. During a telephone call on May 30, 2013, BV once again told KS that the Financier would not do anything until after the confirmation hearing.

On June 6, 2013, the court confirmed the sale of the property to the Lender. Two days later, on June 8, 2013, the bond power for the Shipping Note expired.

I. The Developer Makes Its First Demand for the Retainer but Allows the Financier to Continue Negotiating with the Lender

PG testified that, after the court confirmed the sale of the property, the Developer began having trouble communicating with the Financier. PG said that the Financier's local representative, WP, "basically disappeared. . . . We could never find him." Nor could she find BV. PG said she "would call a variety of telephone numbers" but "not be able to reach him. We called a German office. They'd say he was in a meeting. We called a London number, and they'd have a different location for him. And, in fact, we were becoming increasingly nervous and frustrated."

Unable to reach anyone at the Financier directly, the Developer began relying on Potter to facilitate communications with BV. Potter testified that, with WP out of the picture, he tried "to get [BV] to communicate effectively with [the Developer] and to take this fellow, [WP's], place in terms of communication . . . we tried to keep the dialogue open."

On July 1, 2013, the Developer made its first demand to the Financier for the return of the retainer. In response, BV offered to return part of the retainer while continuing to negotiate with the Lender to buy the property. The Developer accepted BV's offer and did not try to claim the Shipping Note.

PG testified that she did not want to sell the Shipping Note or get the retainer back at that time because that would mean the Developer would never get its property back. PG said, "[W]e didn't want to cause that event until we were sure that it was over with and that they weren't going to perform."

Similarly, when KS was asked at the hearing why he did not demand "immediate collateralization of the [Shipping Note]" in July 2013, he responded, "I don't have any clear memory of that period. It's a big blur. . . . I think we were desperately trying to find ways to keep the [development] project going and also to satisfy my cash needs."

J. The Financier Claims to Have a Deal with the Lender, but Nothing Materializes

Over the next several months, PG and KS continued communicating with BV directly about the Financier's efforts to buy back the property from the Lender and return the retainer to

KS. In late August 2013, BV emailed PG that the Lender would be accepting bids on the property, but there were "a number of legal issues" that the Lender had to address first.

In late October 2013, BV claimed that the Lender had chosen the Financer's bid for the property. On October 27, 2013, PG emailed BV, KS, and RD. PG wrote that she had spoken to Potter, and "heard [the] good news that [the Lender's parent company] has selected [BV's] offer. Additionally, that they are giving a short time for proof of funds and establishing the account at [the title company]."[11]

PG testified that, at the time, she was concerned about the proof of funds issue because she "had been hearing from . . . various sources . . . in Chicago . . . that the problem with [the Financier] was that they had never proved they had the funds . . . it was something we kept hearing from various sources that were talking to [the Lender], and they were giving information back to us."

Over the next several weeks, BV and RD assured the Developer that the Financier was securing the funds needed for the transaction. In early December, BV claimed that the deal essentially was done. PG testified that she spoke with BV on December 2, 2013, and BV said "he's got another deal with [the Lender]. He's got the money, and he's going to close in a couple of days and, you know, all that kind of stuff."

By the end of December 2013, however, the transaction had not closed, and the Financier had not returned the retainer to the Developer.

K. The Financier Tells the Developer the Deal with the Lender Is Off Again

In early January 2014, BV told PG that the Developer's interference had scuttled the latest deal with the Lender. In a January 3, 2014 email, BV wrote, "Unfortunately [one of the Developer's contacts] tried to contact [the Lender] just before Christmas enquiring about our transaction," and that call "set into motion an enquiry that established a direct link to your involvement and compromised representations made by the [the Financier's attorney] and myself. [The Lender] will not entertain any deal in which you or [KN] have a connection."

PG responded, "I am surprised to hear [the Lender] claims to have had a call from [the Developer's contact]," and that she had spoken to the contact and he "absolutely denies making a call." PG continued, "[T]he new CEO of [the Lender] should not hold any animosity nor should [the Lender's parent company] towards [KN] or me. Our defense of our property ownership through bankruptcy was not personal in any case."

KS testified that, around this time, BV "had some supposed health problems and installed" an associate, JVR, to take his place. On January 31, 2014, JVR emailed PG,

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[11] When asked at the hearing what Potter told her during their conversation before she sent this email, PG replied, "The news of the [Lender's] settlement, and that things were going forward, and that we should be relieved now that this is going to get done."

apparently in response to an email from PG asking about the return of the retainer.[12] JVR wrote that he was aware of an agreement "to accommodate the return of part of the $2 million earlier," and that he was "following through on this." JVR repeated BV's assertions that the Financier had been unable to reach a deal with the Lender because of PG's and KN's involvement in the project.

PG responded the same day, arguing that the real problem was the Financier's failure to show proof of funds. PG wrote, "The problem was that [the Financier] could not deliver the money. . . . We have connections to [the Lender] to hear their position. The bottom line has been and always was proof of funds."

On February 2, 2014, PG emailed Potter and asked him to participate in a call with the Developer and JVR. In her email to Potter, PG wrote, "Although you are not in the deal transaction, we would like you to be." PG wrote that she had scheduled a conference call with KS and JVR to "assess [JVR] and his authority and authenticity. . . . Does he know and can he prove they have the funds? I hope you can listen and help us with this transaction."

Potter replied, "I cannot be involved until your relationship is sorted out with [BV] . . . . I suggest you do the call without me."

KS responded to Potter, "Really helpful[.]"

Potter then replied to KS, "If your contract with [BV]'s group [sic] and he has the funds then your deal I assume will move forward. [I]f there is a problem with these two elements plus timing issues then you need alternatives now. There is funding available for well structured urban real estate now[.]" Potter suggested that he and KS speak after the call with JVR.

L. The Developer Is Unable to Sell the Shipping Note

In early February 2014, the Developer learned that the Lender had an agreement to sell part of the property to another entity. Around this time, the Developer approached the transfer agent for the Shipping Note and tried to claim its $3 million. The transfer agent told the Developer that it needed to show proof of ownership for the note. PG testified that when the Developer offered the bond power, "it was determined that it did not work. The bond power was not effective." By this time, the bond power had been expired for more than six months. PG said the transfer agent asked the Developer for "a legal opinion that we actually owned the bonds."

On February 7, 2014, PG emailed Potter and RD asking for their help. In her email, PG blamed BV and the Financier for failing to settle the Developer's debt and costing PG and KS millions of dollars in losses. PG wrote:

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[12] PG's email is not in the record.

> We are now at the end. Commitments, communication and collateral appear to have vaporized. Every story is different from the previous. Urgent messages are sent without a reply. Credibility of [BV] and his cast is nil.
>
> . . . .
>
> Sadly this mess was avoidable. We asked for proof of funds, transparency and participation in the discussion and negotiation. None of this happened. We are sophisticated, experienced and honest. I am faced with solving a 12.5 million dollar deficiency judgment and salvaging my business career and the loss of millions of dollars by me and my family. In addition to his investment in this transaction, [KS] has a 2 million dollar deposit that was to be returned by April 2013 when the transaction was to be completed. [KS] needs to claim the [Shipping Note] now.
>
> Neither [BV] nor anyone from [the Financier] has been to Chicago in a year. How do you do a 120 million dollar deal with[out] meeting your partners or the city or meeting with [the Lender]? [BV] and [the Financier] have singlehanded [sic] been the unnecessary cause of this potential demise. What is the strategy? I have a suggestion but this needs to be discussed.

Potter responded to PG's email, "At this stage I am a secondary communication conduit with [RD] who in turn is a contracted service supplier to the project." Potter wrote he would "try to re emphasis [sic] the critical importance for the parties . . . to communicate and resolve the problems ASAP."

Nine days later, on February 16, 2014, PG emailed Potter authorizing him and RD to sell the entire Shipping Note.[13] PG wrote that Potter would be receiving an opinion letter from the Developer's attorney stating that "the [note] w[as] pledged in [its] entirety for full ownership transfer in return for payment of a deposit of two million dollars," and that the note was "represented to be collateral in substantial excess of the deposit in order to provide both comfort and a substantial upside if there was an unlikely default."[14] The next day, February 17, 2014. the Developer's attorney emailed her opinion letter to Potter.

Apparently, the opinion letter from the Developer's attorney was not sufficient to establish the Developer's ownership of the Shipping Note, and the Developer was unable to sell any part of the note. Potter, KS, and PG each testified that the problem was that the note was in BV's name, and he refused to give permission for the Developer to transfer ownership of any part of it.

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[13] The record does not show what happened between February 7 and 16, 2014.

[14] This is contrary to the Agreement's terms.

In November 2014, the Developer's attorney emailed BV a letter captioned "Final Demand before Filing Suit." The Developer's attorney demanded an assignment of the entire Shipping Note to the Developer. The Developer's attorney wrote that BV and the Financier had defrauded the Developer by "offering a collateral [the Shipping Note] that could not be transferred by the DTC Access Codes alone[.]"[15]

In his emailed response, BV disagreed that the Financier had breached its agreement with the Developer. BV wrote that he "d[id] not accept that any such breach occurred and ha[d] documentation to support that a transaction was agreed in accordance with the Consulting Agreement," and that the Developer knew this because "it was referred to on many occasions in various discussions and emails."

M. Potter Fails to Provide Wire Transfer Information to KS

Months later, KS confronted BV in person and demanded the retainer back. KS testified that he hired an English firm made up of "ex-military, special operations guys" to recover the retainer. KS said the firm had "quite an extensive file" on BV and informed him that BV previously "had been in prison for five years in Her Majesty's Prison for fraud." KS testified that the firm "arranged a meeting for [KS] with [BV] early in the morning outside [BV's] house. And the meeting took place in the back of a Range Rover [the firm] had provided." According to KS, BV told him that he had not returned the $2 million because the Developer "never appropriately asked for it in the right format per the contract," and because he was angry that the Developer had tried to "take down $80 million worth of bonds," which "wasn't the intent" of the Agreement.

In January 2016, KS emailed Potter seeking information about where Meredith Financial had sent the $2 million retainer. In his email, KS asked Potter to provide "the bank account information where Meredith [Financial] initially sent the $2mm to [BV]." KS wrote that he was "actively pursuing this as a fraud case and this information will be helpful." Potter responded that he would check the bank records and get back to KS, but he never did.

Neither the Developer nor KS filed a lawsuit against anyone involved in the transaction. KS testified he hired a law firm to investigate suing the Financier and BV but he decided against it. PG testified that the Developer also considered taking legal action, but it did not have enough money to pay an attorney and none was willing to take the case on contingency. The Developer did, however, contact law enforcement, including the United States Postal Inspection Service.

III. Procedural History

In June 2017, postal inspectors contacted FINRA regarding the refinancing transaction. In December 2017, Enforcement opened an investigation into Potter's role in the transaction.

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[15] There is no evidence BV told the Developer the Shipping Note could be transferred with the DTC codes alone.

In August 2018, Enforcement filed a two-cause complaint against Potter alleging several violations of FINRA Rule 2010. Under the first cause, Enforcement alleged that Potter converted about $25,000 of the retainer by using that amount to cover withdrawals from Meredith Financial's checking account on March 12 and 13, 2013. Under the second cause, Enforcement alleged that Potter misused the rest of the retainer by releasing it prematurely on March 15, 2013. Also under the second cause, Enforcement alleged that Potter acted unethically by not disclosing to the Developer an alleged conflict of interest arising from the expected repayment of the Swiss Advisor's debt to Meredith Financial from the retainer proceeds, and by hindering the Developer's efforts to recover the retainer from the Financier.

In August 2019, after a four-day hearing during which Potter, PG, KS, and a FINRA examiner testified, the Hearing Panel issued its decision finding Potter liable under both causes of action alleged in the complaint. The Hearing Panel imposed bars under each cause and ordered Potter to pay KS restitution totaling $250,000. This appeal followed.

IV. Discussion

FINRA Rule 2010 requires associated persons, in the conduct of their business, to "observe high standards of commercial honor and just and equitable principles of trade." The rule is not limited to rules of legal conduct, but rather states a broad ethical principle. *Dep't of Enf't v. Shvarts*, Complaint No. CAF980029, 2000 NASD Discip. LEXIS 6, at *11 (NASD NAC June 2, 2000) (discussing FINRA Rule 2010's predecessor, NASD Rule 2110). The ethical standards imposed under FINRA Rule 2010 go beyond legal requirements, and depend on general rules of fair dealing, the reasonable expectations of the parties, marketplace practices, and the relationship between the parties. *Id.* at *12. We may find a violation of ethical obligations when no legally cognizable wrong has occurred. *Id.* at *11. To establish a Rule 2010 violation when there is no violation of any other FINRA rule or federal securities law, Enforcement must prove that the respondent acted unethically or in bad faith. *Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 SEC LEXIS 3583, at *33 (discussing FINRA Rule 2010's predecessor, NASD Rule 2110). Conduct is unethical when it is "not in conformity with moral norms or standards of professional conduct," while bad faith means "dishonesty of belief or purpose." *Id.* at *33. In determining whether a Rule 2010 violation occurred, we employ "a flexible evaluation of the surrounding circumstances with attention to the ethical nature of the conduct." *Shvarts*, 2000 NASD Discip. LEXIS 6, at *15.[16]

A. Enforcement Failed to Establish that Potter Violated FINRA Rule 2010 by Not Disclosing His Alleged Conflict of Interest

Misrepresentations of material fact are inconsistent with just and equitable principles of trade and violate FINRA Rule 2010. *Dep't of Enf't vs. Niekras*, Complaint No. 2013037401001, 2018 FINRA Discip. LEXIS 25, at *37 n.26 (FINRA NAC Oct. 4, 2018). Omissions of material fact also violate FINRA Rule 2010, but only when a person is under an affirmative duty to disclose the fact, commonly known as a "duty to speak." *See Dep't of Enf't vs. Bullock*,

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[16] We address the alleged violations in chronological order rather than by cause of action.

Complaint No. 2005003437102, 2011 FINRA Discip. LEXIS 14, at *34 (FINRA NAC May, 6, 2011).

Enforcement alleged in its complaint that Potter acted unethically by allowing the Developer to enter into the Agreement without disclosing an alleged conflict of interest. Enforcement alleged that Meredith Financial was supposed to act as a "neutral third party" between the Developer and Financier, but it could not do so because the Swiss Advisor's expected repayment of its debt created a conflict of interest for Potter. Enforcement theorized that, during the period Meredith Financial was holding the retainer (i.e., before the conditions for release were satisfied), in the event of a dispute in which the Developer demanded its money back, Potter would have an interest in not returning the money because, if he did, Meredith Financial would not get its $250,000 from the Swiss Advisor. Enforcement alleged that Potter acted unethically by not disclosing this conflict of interest to the Developer.

The Hearing Panel agreed with Enforcement. It found that Potter "knew he would obtain a significant infusion of much needed cash" from the Swiss Advisor, and therefore he had a "financial interest in the transaction." The Hearing Panel concluded that Potter "should have disclosed his significant financial interest in serving as a facilitator of the [] Agreement."

Potter contends the Hearing Panel erred because, even if he had a conflict of interest, which he maintains he did not, he had no duty to disclose it.[17] Citing New York law, Potter asserts that "there is no duty to speak which arises simply because the parties enter into a transaction."

Enforcement concedes that Potter had no legal duty to disclose the alleged conflict of interest, but it contends he had an ethical duty to do so, which is all that is necessary to establish a violation under FINRA Rule 2010 in this case. Enforcement argues that Potter had an ethical duty to disclose his alleged conflict of interest because the Developer reasonably expected he would. According to Enforcement's brief, the Developer expected Potter to "act independently and with prudence and responsibility," and Potter understood his role was to provide a "trust factor" between the Developer and the Financier. Enforcement asserts that "Potter's failure to tell [the Developer] that he had a financial interest in the transaction [therefore] was dishonest and contrary to basic principles of fair dealing and [the Developer's] reasonable expectations."

Enforcement and Potter both are partially correct. Enforcement is correct that we need not find a violation of law to find a violation of Rule 2010 here, and that we must give effect to the reasonable expectations of the parties to the relationship. *Shvarts*, 2000 NASD Discip. LEXIS 6, at *12. However, before we can find Potter liable based on the Developer's reasonable expectations, we must find that those expectations were, in fact, reasonable. *See Dep't of Mkt. Regul. v. Leighton*, Complaint No. CLG050021, 2010 FINRA Discip. LEXIS 3, at *158 (FINRA NAC Mar. 3, 2010) (finding that institutional customers' expectations about the markups or

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[17] Potter contends he had no interest in the refinancing transaction because the payment he received from the Swiss Advisor was for a pre-existing debt and Meredith Financial was entitled to payment of the debt regardless of the refinancing transaction.

markdowns they would be charged were not reasonable given the law, FINRA rules, and industry standards and practices). "Reasonableness" is an objective standard. Absent an explicit agreement to the contrary, one party's reasonable expectations are defined by the generally recognized duties owed to it by the other party. *See id.*; *see also Dante J. DeFrancesco*, Exchange Act Release No. 66113, 2012 SEC LEXIS 54, at *19 (Jan. 6, 2012) ("In analyzing a securities professional's conduct under [FINRA Rule 2010], we frequently have focused on whether the conduct implicates a generally recognized duty owed to clients or the firm."). These duties may arise from the law, pre-existing industry standards and practices, or even from a firm's policies and procedures. *See, e.g.*, *Leighton*, 2010 FINRA Discip. LEXIS 3, at *158 ("The Commission has construed [FINRA Rule 2010] to prohibit practices that violate pre-existing standards with respect to a broker-dealer's obligations to its customers."); *Dep't of Enf't. v. Golonka*, Complaint No. 2009017439601, 2013 FINRA Discip. LEXIS 5, *24 (FINRA NAC Mar. 4, 2013) (finding that respondent's conduct violated Rule 2010 because it was contrary to "fundamental principles of agency law," as well as the firm's code of ethics). In other words, Enforcement is correct that it does not have to prove that Potter had a *legal* duty to speak, but Potter is correct that Enforcement must prove that he had *some* duty to speak.

There is no evidence that Potter had a duty to speak arising from an explicit agreement between the Developer and Meredith Financial or Potter. The Agreement does not contain any term relating in any way to Meredith Financial's independence from the Financier or Meredith Financial's lack of interest in the transaction.[18]

Absent an explicit agreement to disclose the alleged conflict of interest, Potter's ethical duty to speak depends on the standard of care that he owed to the Developer. Enforcement does not identify the standard of care that applies in an arm's-length, commercial transaction between sophisticated parties.[19] Generally, however, in such a transaction, a party's ethical duties align with its legal obligations. *See Leighton*, 2010 FINRA Discip. LEXIS 3, at *158-59 (finding that a trader did not act unethically by not disclosing to institutional customers information he had no legal duty to disclose); *cf. Dep't of Enf't v. C.L. King & Assocs, Inc.*, Complaint No. 2014040476901, 2019 FINRA Discip. LEXIS 43, at *34 (FINRA NAC Oct. 2, 2019) (holding that the hearing panel erred in applying the "general negligence standard [of care] used when a broker is recommending a security to a customer" in the context of an arm's-length transaction between sophisticated parties). In these situations, a duty to speak arises when either (a) one party already has made an affirmative statement of material fact and additional facts are needed to make that statement not misleading, or (b) one party has a fiduciary or similar relationship of trust and confidence with the other. *See id.*; *see also PXRE Reins. Co. v. Lumbermens Mut. Cas.*

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[18] To the contrary, the Agreement strongly suggests that Meredith Financial acted as the Financier's agent. The Agreement provided that Meredith Financial would receive the retainer "on [BV's] behalf," and that the Swiss Advisor (the Financier's agent) had "instructed Meredith [Financial] to assist and facilitate in the execution of this Agreement."

[19] Enforcement does not assert that the Developer was Potter's customer or that this was a securities transaction. Heightened standards of care that may apply in those specific contexts are inapplicable.

Co., 342 F. Supp. 2d 752, 757 (N.D. Ill. 2004) (stating that "the duty to speak arises only when a fiduciary relationship is present or when the defendant's acts contribute to the plaintiff's misapprehension of a material fact and the defendant intentionally fails to correct plaintiff's misapprehension").

Enforcement did not establish that Potter had a duty to speak based on a prior representation of material fact.[20] There is no evidence that, before the Developer entered into the Agreement, Potter made an affirmative statement that he had no interest in the transaction. Potter spoke one time each with PG and the Developer's attorney before the transaction was consummated. There is no evidence that during either conversation the participants discussed Potter's neutrality or whether he expected to benefit from the transaction. To the contrary, Potter testified that during his call with PG, she did not ask him about those subjects, even though she was aware of his past business dealings with the Swiss Advisor. PG's testimony did not contradict Potter's. Potter testified that his conversation with the Developer's attorney was limited to discussing the exchange of the retainer and security. The Developer's attorney did not testify at the hearing, but the email she drafted just after the conversation is consistent with Potter's testimony.

Potter also did not have a duty to speak based on a fiduciary or similar relationship of trust and confidence with the Developer. Enforcement concedes that Potter was not the Developer's fiduciary, and the record does not establish that Potter and the Developer had a relationship of trust and confidence. A relationship of trust and confidence, sometimes called a confidential relationship, is the functional equivalent of a fiduciary relationship, and "involves confidence and trust on one side and dominance and influence on the other." *Carey Elec. Contracting, Inc. v. First Nat'l Bank*, 392 N.E.2d 759, 763 (Ill. App. Ct. 1979). "Normal trust between friends or businesses . . . do[es] not operate to turn a formal, contractual relationship into a confidential or fiduciary relationship. A confidential relationship only goes to a situation where one party, because of some close relationship, relies very heavily on the judgment of another." *Id.* at *763-64.

There is no evidence that the Developer relied "very heavily" on Potter's judgment. The Developer was no less sophisticated than Potter. PG had four decades of business experience and was overseeing a $65 million redevelopment project. KS was a successful entrepreneur. The Developer was represented by counsel throughout the transaction and negotiated the terms of its agreement with the Financier before Potter became involved. The Developer did not rely on Potter's expertise as a securities professional; the Developer did not ask Potter's advice about the sufficiency of the bond power or the DTC codes, and Potter did not offer it. Instead, the Developer relied on its own attorney, banker, and broker-dealer, all of whom assured the Developer that the bond power and DTC codes were adequate to secure the $2 million retainer.

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[20] The Hearing Panel made a credibility determination based, in part, on Potter's alleged "representations to [the Developer] that he was an uninterested third party." There is no evidence, however, that Potter made any such representation before the Developer entered into the Agreement.

Potter's contractual role in the transaction was limited to handling the exchange of the retainer and security, an administrative task that required no specialized knowledge. While we do not doubt that the Developer trusted Potter and expected him to comply with Meredith Financial's contractual obligations, that alone is not enough to create a confidential relationship, especially under these circumstances.[21]

Moreover, the record does not support a factual finding that the Developer expected Potter, for all intents and purposes, to act like a fiduciary by putting the Developer's interests before Meredith Financial's. The Developer had experience using escrow agreements but chose not to use one here. The Developer's decision not to use an escrow agreement undercuts Enforcement's assertion that the Developer expected Potter to act like a fiduciary.[22] Additionally, the Agreement was negotiated by the Developer's attorney, yet it does not include any representation about Potter's neutrality or his lack of interest in the transaction.

The only evidence Enforcement offers to support its assertion about the Developer's expectations is PG's testimony. But PG's testimony on this issue was equivocal, and on balance, evidences only an expectation of contractual performance. When PG was asked to describe the Developer's relationship with Potter at the time the Agreement was executed, she responded: "Well, we didn't know him very well. We had done research about him and about Meredith, but we had not begun getting to know him, so to speak." When PG was asked what the Developer expected from Potter and Meredith Financial, she responded: "We expected that they would make sure that all of the terms and conditions of the contract were satisfied in accordance with the contract. So it's spelled out pretty clearly that it was a process of obtaining that collateral before the release of the money." When PG was asked whether she considered Potter to be the Developer's agent at the time the agreements were executed, she responded: "At that time, *we believed he was an agent of [the Financier]* [emphasis added], but an intermediary with the credibility that he would not—that he had to take care of this . . . and was independent from that standpoint." PG continued, "In other words . . . we believed that he would act independently and with prudence and with responsibility." The Developer's expectation that Potter would fulfill

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[21] *See, e.g.*, *Leighton,* 2010 FINRA Discip. LEXIS 3, at *124 ("We recognize that buy-side traders testified that they placed their 'trust' and 'confidence' in [respondent] and expected him to use his brokerage judgment to help them get the best possible executions for their orders. These facts alone, however, do not compel a finding that [respondent] assumed the role of a fiduciary."); *Carey Elec.*, 392 N.E.2d at 764 ("We do not say that businesses linked by contract can never be found to be parties in a confidential relationship, but mere allegations that one businessman simply trusted another to fulfill his contractual obligations is certainly not enough. If we were to hold otherwise, most contracting parties might well be found to be in this type of confidential relationship.").

[22] The Agreement was governed by Illinois law. Under Illinois law, an escrow agent has an "obligation as a fiduciary not only to act with reasonable care in carrying out the duties prescribed by the escrow agreement, but also to do so with fidelity, honesty, and good faith necessary to uphold its obligation to remain impartial." *FDIC v. Chi. Title Ins. Co.*, No. 12-cv-05198, 2019 U.S. Dist. LEXIS 207721, at *9 (N.D. Ill. Dec. 3, 2019).

Meredith Financial's contractual obligations does not establish that the Developer, in fact, expected Potter to put its interests ahead of Meredith Financial's by disclosing the alleged conflict of interest.

For these reasons, Enforcement failed to establish that Potter had an ethical duty to disclose his alleged conflict of interest. We therefore reverse the Hearing Panel's finding that Potter's conduct in this respect violated FINRA Rule 2010, and we dismiss this element of the complaint's allegations.

B. Enforcement Failed to Establish that Potter Violated Rule 2010 by Converting the Retainer

Conversion is "an intentional and unauthorized taking of and/or exercise of ownership over property by one who neither owns the property nor is entitled to possess it." *Dep't of Enf't v. Grivas*, Complaint No. 2012032997201, 2015 FINRA Discip. LEXIS 16, at *13 (FINRA NAC July 16, 2015), *aff'd*, Exchange Act Release No. 77470, 2016 SEC LEXIS 1173 (Mar. 29, 2016). Conversion violates FINRA Rule 2010. *Id.*

Enforcement's conversion allegation is based solely on the drop in balance in Meredith Financial's checking account on March 12 and 13, 2013, while the company was in possession of the retainer. On those days, there were several withdrawals from the checking account that reduced the account balance to $1.975 million. But for the company's receipt of the $2 million retainer, Enforcement claims, the checking account would have been overdrawn by about $25,000 on March 13. Enforcement alleged that Potter therefore converted about $25,000 of the retainer to cover the withdrawals.

The Hearing Panel found Potter liable for conversion as alleged in the complaint. The Hearing Panel found that the Agreement "authorized Potter to hold the funds until the preconditions for releasing them were met, and then to release the funds to [the Financier]. It did not authorize Potter to withdraw at any time any part of the deposit for his personal or business use, and Potter neither sought nor obtained permission to do so."[23]

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[23] The Hearing Panel based its liability finding on its factual finding that Meredith Financial did not have sufficient assets of its own to cover the withdrawals from the checking account, and therefore must have used the retainer to cover the withdrawals. This factual finding is not supported by the record. Potter offered unrebutted evidence that Meredith Financial had access to funds sufficient to cover the $25,000 in withdrawals. Potter testified that, at the time of the withdrawals, Meredith Financial had access to a brokerage account that held securities worth between $50,000 and $100,000, and that Meredith Financial could have used those assets to cover the withdrawals, if necessary. Documents introduced at the hearing are consistent with Potter's testimony, including FINRA Rule 8210 requests from Enforcement and Potter's responses to those requests. Enforcement did not dispute the existence of the brokerage account or the availability of the securities held in it to cover the withdrawals. Potter further testified that he had pledged a $100,000 home equity line of credit to Meredith Financial, and that the credit line was available to the company to cover the withdrawals, if necessary. Potter introduced into

[Footnote continued on next page]

We reverse the Hearing Panel's finding of violation because the record does not establish that Potter's use of funds held in Meredith Financial's checking account was unauthorized.

Enforcement's conversion allegation erroneously assumes Potter had a duty to segregate the retainer within Meredith Financial's checking account. But no such obligation existed. Indeed, the Agreement did not impose any restrictions on Meredith Financial's handling of the retainer once the funds were deposited into the company's checking account. The Agreement did not require Meredith Financial, which is not a broker-dealer, to hold the funds in an escrow account, nor did the Agreement require the company to segregate the funds, which were not a broker-dealer's customer funds, in any way. To the contrary, the Agreement explicitly required the Developer to wire the funds into Meredith Financial's checking account, where they instantly became commingled. The Agreement did not require Meredith Financial to hold the funds in its checking account, or to maintain a minimum balance in the checking account while it was in possession of the retainer. Put simply, Meredith Financial's use of the funds in its checking account was in no way restricted under the Agreement, and therefore Potter's use of the funds in the account to cover the withdrawals was not unauthorized.[24]

[cont'd]

evidence a "Home Equity Line of Credit Agreement and Disclosure Statement" dated December 24, 2007. Enforcement did not dispute the availability of the home equity line of credit. Nevertheless, the Hearing Panel found Potter's testimony about the brokerage account and home equity line of credit was not credible because "he provided no evidence of such resources." We set aside the Hearing Panel's credibility finding because the Hearing Panel failed to consider the documentary evidence supporting Potter's testimony. *See Dep't of Enf't v. Trevisan*, Complaint No. E9B2003026301, 2008 FINRA Discip. LEXIS 12, at *16 (FINRA NAC Apr. 30, 2008) (stating that we may set aside a Hearing Panel's credibility findings if the Hearing Panel "does not discuss the substantial amount of record evidence that appears to contradict those findings").

[24] In support of its argument that Potter converted the retainer, Enforcement cites *Keilen Dimone Wiley*, in which the Commission held that an insurance agent converted insurance premiums when he deposited them into his general business bank account and used the money to pay personal and business expenses. *See* Exchange Act Release No. 76558, 2015 SEC LEXIS 4952 (Dec. 4, 2015). *Wiley* is inapposite. The respondent in *Wiley* was an agent for an insurance company and had agreed to adhere to the company's policies. *Id.* at *3. The company's policies explicitly required agents to deposit premium payments into a special account and prohibited them from commingling premium payments with other funds. *Id.* at *3-4. Wiley's commingling and spending of the premium payments therefore was explicitly prohibited. Enforcement also cites *Blair Alexander West*, Exchange Act Release No. 74030, 2015 SEC LEXIS 102 (Jan. 9, 2015). *West* also is not on point. In *West*, the respondent's customer told him that it could not pay a deposit unless the deposit was held in an escrow account. *Id.* at *6-7. The respondent represented that it would be. *Id.* When the respondent received the deposit, rather than placing it in escrow, he spent it. *Id.* at *8-9. West's spending of money that was supposed to be held in escrow was not authorized. *Id.* at *21-23.

Enforcement suggests that, because the contract did not specifically authorize Potter to use the funds held in Meredith Financial's checking account to cover the withdrawals, we should assume that such use was prohibited. We disagree. The Developer was sophisticated, represented by counsel, and had experience with escrow agreements. Had the Developer wanted the retainer funds to be held in escrow, segregated from other funds, or protected in any way, it knew how to accomplish that.[25] Under the circumstances of this case, we will not imply an essential term that the parties to the Agreement could have included but did not.[26]

We note that Potter did not have a fiduciary or confidential relationship with the Developer, and therefore principles of agency law did not govern Meredith Financial's handling of the retainer. When an associated person obtains money or property in the context of fiduciary or confidential relationship, he or she has an ethical obligation to exercise a heightened standard of care. The associated person must keep the money or property safe and must not commingle it.[27] The associated person must not appropriate the money or property for his or her own use or any other unauthorized use.[28] These duties, however, are rooted in agency, not contract.[29] Potter

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[25] *See, e.g.*, *C&H Transp. Co. v. Constr. & Indus. Equip., Inc.*, No. 84 C 10535, 1988 U.S. Dist. LEXIS 5655, at *6 (N.D. Ill. June 10, 1988) (stating that when interpreting a contract, "[i]t is common ground that a court looks to the litigants' objective manifestations of intent, not to any post-hoc assertions of what one side 'really' intended but failed to communicate").

[26] *See, e.g.*, *Devco v. T10 Meltel, LLC*, 237 F. Supp. 3d 804, 816 (N.D. Ill. 2017) ("There is a strong presumption against provisions that easily could have been included in the contract but were not.").

[27] *See, e.g.*, *Henry E. Vail*, 52 S.E.C. 339, 342 (1995), *aff'd*, 101 F.3d 37 (5th Cir. 1996) (sustaining FINRA's finding that the applicant violated FINRA's high standards of commercial honor and just and equitable principles of trade when the applicant, while acting as a fiduciary of a political club, commingled his and the club's funds); *Peter Paul Glagola*, 47 S.E.C. 290 (1980) (finding that the applicant "engaged in conduct inconsistent with just and equitable principles of trade by . . . commingling customers' funds with those of his wife, and converting the customers' funds to his own use").

[28] *See, e.g.*, *Julie S. Westberry*, Complaint No. C07940021, 1995 NASD Discip. LEXIS 225, at *20 (NASD NAC Aug. 11, 1995) (stating that "brokers who are entrusted with the safekeeping of customer funds must take extra care to ensure that those funds are used only as authorized by the customer and only in the customer's best interest").

[29] *See, e.g.*, *Louis Feldman*, 52 S.E.C. 19, 22 (1994) (stating the respondent's transfer of customer accounts to another firm without consent violated FINRA Rule 2010's predecessor because "[w]hile there may be no specific NASD rule addressing the matter, under fundamental principles of agency law such prior consent is required").

did not have a fiduciary or confidential relationship with the Developer, and therefore these principles do not apply here.[30]

For these reasons, Enforcement failed establish that Potter's use of funds in Meredith Financial's checking account to cover withdrawals from the account was unauthorized. We therefore reverse the Hearing Panel's finding that Potter engaged in a conversion of funds that violated FINRA Rule 2010 and dismiss this allegation.

C. Enforcement Failed to Establish that Potter Violated Rule 2010 by Misusing the Retainer

Misuse, also known as misappropriation, is defined as an unauthorized or improper use of funds or property for a purpose other than that for which the funds or property were intended. *See Dep't of Enf't v. Evans*, Complaint No. 2006005977901, 2011 FINRA Discip. LEXIS 36, at *33 n.33 (FINRA NAC Oct. 3, 2011).

Enforcement alleged that, under the Agreement, Meredith Financial was not authorized to release the retainer to anyone until April 1, 2013. Enforcement alleged that Potter erroneously believed Meredith Financial could release the retainer on March 15, 2013, because he "never attempted to understand [Meredith Financial's] obligations under [the Agreement], and thus acted with reckless disregard of [Meredith Financial's] obligations to [the Developer.]" Enforcement alleged that Potter's allegedly premature release of the retainer on March 15 constituted misuse.

The Hearing Panel disagreed with Enforcement's assertion that Meredith Financial was not authorized to release the retainer on March 15, but it nevertheless found Potter liable for misuse on a theory not alleged in the complaint. The Hearing Panel concluded that Meredith Financial was authorized to release the retainer once certain conditions were satisfied, and that those conditions were satisfied on March 14. As a result, Meredith Financial's release of the retainer on March 15, in and of itself, did not breach the terms of the Agreement. However, the

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[30] The Commission and federal courts long have distinguished between violations of Rule 2010 arising from breaches of fiduciary duty and those arising from breaches of contract. *See, e.g.*, *Heath v. SEC*, 586 F.3d 122, 137 (2d Cir. 2009) ("This is a breach of confidence case, which implicates quintessential ethical considerations not necessarily implicated in a breach of contract case. Thus, the axiom that [the exchange's 'just and equitable principles of trade' rule] prohibits mere unethical conduct and does not require scienter holds true in this case.") (discussing analogous New York Stock Exchange rule); *William D. George, III*, 47 S.E.C. 368, 369-70 (1980) (finding that the respondent's breach of his contractual obligation to indemnify customers for losses was not a violation of Rule 2010's predecessor because there was no evidence the respondent breached the contract in bad faith); *Robert J. Jautz*, 48 S.E.C. 702, 704 (1987) (finding that respondent's breach of a loan agreement with customer was not a violation of Rule 2010's predecessor because "it is well established that a breach of contract violates NASD standards only if it is committed in bad faith or is accompanied by unethical conduct").

Hearing Panel further found that, while Meredith Financial was authorized to release the retainer on March 15, it could release the money *only* to the Financier, not to the Financier's Affiliate, the Swiss Advisor, or Meredith Financial. The Hearing Panel found that Potter "should not have" released the retainer to anyone but the Financier "without first consulting with [the Developer]," because Potter "understood he was an intermediary, entrusted to effect the transfers of funds and documents pursuant to [the Agreement]."[31]

We reverse the Hearing Panel's finding of violation because the record does not establish that Potter's release of the retainer to the Financier's Affiliate, Swiss Advisor, and Meredith Financial was unauthorized or that it was for a purpose other than that for which the retainer was intended.

The Agreement does not contain any term requiring Meredith Financial to release the retainer only to the Financier. The Agreement provides terms describing *when* Meredith Financial may release the retainer, but not to *whom* it may release the retainer. There is no dispute that the Financier was entitled to the retainer on March 15. The Agreement does not contain any term requiring Meredith Financial to pay the retainer to any specific person, entity, or account. Indeed, the Agreement does not contain any payment term at all. Had the Financier not provided further instructions to Meredith Financial, through the Swiss Advisor, Meredith Financial would not have known where to send the money.

The Financier explicitly authorized the Swiss Advisor to receive the retainer on its behalf. In a letter to the Swiss Advisor dated March 8, 2013, which the Swiss Advisor forwarded to Potter, and Potter forwarded to the Developer, BV wrote, "We would be grateful if you would make arrangements with Meredith Financial Group to receive the [retainer] on our behalf and upon instruction facilitate either return [of] the [retainer] or release the Access Codes to [the Developer]." The Developer's attorney received a copy of BV's letter on March 13, and the Developer did not object to the Swiss Advisor's receipt of the retainer. Meredith Financial therefore was authorized to release the retainer to the Swiss Advisor, in accordance with the Financier's instructions.

The Developer and Financier intended for the Financier to spend the money without restriction. The Agreement did not limit the Financier's use of the retainer in any way. The Developer knew that the Financier would spend the money immediately, and it specifically knew that the Financier intended to pay at least some of the retainer to the Swiss Advisor. The Developer did not object. Therefore, the Financier's payment of the retainer to the Financier's

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[31] Because we find that Potter did not misuse the retainer under the Hearing Panel's theory of liability, we do not consider whether it was appropriate for the Hearing Panel to find Potter liable on a theory not alleged in the complaint. *See Dep't of Enf't v. Zenke*, Complaint No. 2006004377701, 2009 FINRA Discip. LEXIS 37, at * (FINRA NAC Dec. 14, 2009) (dismissing complaint because the "Hearing Panel improperly found [respondent] liable for misconduct that was beyond the scope of the allegations in the complaint").

Affiliate and Swiss Advisor, and the Swiss Advisor's subsequent payment to Meredith Financial, were not for a purpose other than that for which the retainer was intended.[32]

For these reasons, Enforcement failed to establish that Potter misused the retainer. We therefore reverse the Hearing Panel's finding of violation and dismiss this element of the complaint's allegations.

D. Enforcement Failed to Establish that Potter Violated Rule 2010 by Hindering the Developer's Efforts to Recover the Retainer

Enforcement alleged that Potter acted unethically by hindering the Developer's efforts to recover the retainer from the Financier. Specifically, Enforcement alleged that, "[w]hen asked, Potter refused to tell the [the Developer] that he had a retained a portion of [the retainer]," and "refused to tell [the Developer] where he had wired $1.75 million of its [retainer], hindering [the Developer's] attempts at recovery."

The Hearing Panel found Potter liable under FINRA Rule 2010 for hindering the Developer's efforts to recover the retainer. In its decision, the Hearing Panel wrote that "for months after disbursing and using [the Developer's] retainer, Potter repeatedly vouched for the integrity of RD and BV, successfully assuaging PG's and KS's heightening concerns, giving unfounded reassurances that they simply needed to trust that BV would perform as promised." The Hearing Panel concluded that "Potter thereby rendered critical assistance to BV's effort to deceive [the Developer] as it sought to recover its funds from him, in violation of Rule 2010." The Hearing Panel further found that Potter acted unethically by telling PG, in October 2013, that he did not have "an interest financially in the transaction," and when he failed to tell KS, in 2016, where he had wired the retainer. We disagree with each of these findings.

1. The Record Does Not Establish that Potter Rendered "Critical Assistance" to BV

Enforcement's complaint and the Hearing Panel's decision imply that the Financier and BV defrauded the Developer and that Potter aided and abetted the fraud. The record does not

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32 The Developer's decision not to impose any restrictions on the Financier's use of the retainer likely stemmed from the Developer's desperation to save its property and its belief that the retainer was fully secured. At the time, it seemed there were only three possible outcomes, all of which were favorable for the Developer: Either (a) the Financier would settle the Developer's debt, save the Developer's property, and earn the retainer as part of its fee; (b) the Financier would not settle the debt, but would return the full $2 million retainer to the Developer; or (c) the Financier would not settle the debt and not return the retainer, but the Developer would sell $3 million of the Shipping Note and keep the extra $1 million. There is no evidence that Potter had reason to believe any differently than the Developer when the Swiss Advisor told him to keep $250,000 of the retainer as payment for its debt. At the time, it appeared that, no matter how the money was spent, there was little risk of loss for the Developer.

support either implication. Certainly, it appears that the Financier breached its agreement with the Developer by not returning the retainer, but there is insufficient evidence in the record to conclude that the Financier entered into the refinancing transaction intending to steal $2 million from the Developer, much less that Potter was aware of or involved in the scheme.

The Financier provided the agreed upon security to the Developer before receiving the $2 million retainer. Contrary to Enforcement's allegations in its complaint, there is no evidence that the security was defective at the time the Financier provided it.[33] When the Developer received the bond power and DTC codes, it consulted with its own attorney, banker, and broker-dealer and determined they were sufficient to secure the retainer. PG testified that nobody ever told her the bond power was defective. There is no evidence that the DTC codes were defective, either. The only evidence of any defect in the DTC codes is that the Developer could not use the codes by themselves to gain control of the Shipping Note. But Enforcement explicitly alleged in its complaint that the "[b]ond [p]ower and all twelve DTC Access Codes were required to take possession of the [Shipping Note]," and there is no dispute that the bond power had expired by the time the Developer tried to use it. Put simply, there is no evidence that, had the Developer tried to use the bond power and DTC codes before the bond power expired on June 8, 2013, it would not have been able to do so.

Additionally, there is extensive evidence that the Financier, in fact, engaged in substantive negotiations with the Lender for several months. PG's emails and testimony establish that the Developer was receiving information about the Financier's negotiations with the Lender from its contacts in Chicago throughout 2013 and into early 2014. Unfortunately, the Financier apparently did not have sufficient funds to meet the Lender's price. Even more unfortunate, the Developer apparently failed to notice the bond power's expiration date until it was too late. By the time the Developer tried to use the bond power, it had expired. The Financier then refused to return the retainer, claiming it had fulfilled its contractual obligations. Whether there is any legal merit to the Financier's claim that it had fulfilled its obligations is unknown because the Developer chose not to take legal action against the Financier.

There is no evidence that Potter had any more reason to believe that the Financier would not perform its contractual obligations than the Developer did. There is no evidence that Potter knew BV or had any business dealings with the Financier until this transaction. Potter does not dispute that he had done business with RD and the Swiss Advisor before this transaction, but Enforcement offered no evidence that Potter had reason to believe RD and the Swiss Advisor were not trustworthy.

There is no evidence that Potter had any reason to believe that the Developer's retainer was not fully secured by the bond power and DTC codes. Enforcement offered no evidence that Potter was aware of any defect in the bond power or DTC codes, or that he had any reason to suspect they were defective.

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[33] Enforcement alleged in its complaint that the "purported [b]ond [p]ower was defective."

The evidence does not establish that Potter was responsible for the Developer's decision not to exercise its right to the Shipping Note before the bond power expired. The Developer was communicating regularly with BV throughout May 2013 up until June 6, 2013, when the court confirmed the judicial sale. The bond power expired two days later, on June 8, 2013. There is no evidence that Potter influenced the Developer's decision not to demand its retainer back, or not to exercise its right to the Shipping Note, before the bond power expired. Instead, the evidence shows that the Developer did not want the retainer back; it wanted the Financier to keep negotiating with the Lender and buy back the property.

The record does not establish that, once the bond power expired, Potter was responsible for the Developer's decision to allow the Financier to keep negotiating with the Lender until February 2014. On July 1, 2013, the Developer made its first demand for the return of the retainer but chose not to pursue it after the Financier promised to return part of the retainer to KS while continuing to negotiate with the Lender. When KS and PG were asked at the hearing why the Developer did not try to claim the Shipping Note before July 2013, neither blamed Potter. PG's testimony makes clear that the Developer did not want its retainer back, and did not want to sell the Shipping Note, because that would mean the end of the Financier's efforts to buy back the property from the Lender and, consequently, the end of the Developer's redevelopment plans.

The record does not support the Hearing Panel's finding that Potter "repeatedly vouched for the integrity of RD and BV, successfully assuaging PG's and KS's heightening concerns, giving unfounded reassurances that they simply needed to trust that BV would perform as promised." From August through December 2013, BV and RD repeatedly offered assurances of progress to PG and KS. Potter often was copied on emails the parties exchanged, but he did not respond to most of them. When Potter did respond, he typically did nothing more than pass on information he obtained from the Financier to the Developer or vice versa.

There is no contemporaneous evidence that, during this period, Potter was offering "unfounded reassurances" to PG or KS to keep them from enforcing the Developer's rights under the Agreement. To the contrary, the record shows that when Potter was given the chance to reassure PG or KS, he did not do so. For example, in October 2013, PG wrote in an email to Potter, "We always have fear in the back of our minds that [BV] is a fraud. [The Lender] likely has the same discomfort with [BV] given their demands. However and nonetheless, his depth of understanding and diligence of the transaction has reassured us." In response to PG's email, Potter did not offer any reassurances about BV. Instead, Potter replied, "[I] suggest, from the outside, you get [KS] and [BV] on the same page and make sure all your interests now and in the future are aligned."

Similarly, in late November 2013, KS forwarded to Potter an email he had received from BV about IRS requirements imposed on wire transfers from Swiss banks that purportedly were delaying the return of the retainer. KS asked Potter if BV's email made any sense. Potter did not offer any reassurances. Instead, Potter replied, "I do not know anything about the transaction. . . . [Y]our accountant can give you details and any effect on timing for a wire transfer."

And in February 2014, when PG asked Potter to participate in a conference call with BV's replacement, JVR, to "assess [JVR] and his authority and authenticity. . . . Does he know and can he prove they have the funds," Potter did not offer any reassurances about BV, JVR, or the Financier. Instead, Potter responded that the Developer should do the call without him. When KS criticized Potter's response as "really helpful," Potter responded that if the Financier did not have the funds "then you need alternatives now[.]"

Tellingly, there are many emails in the record sent by PG and KS between April 2013 and February 2014 complaining about BV's unresponsiveness, changing stories, and overall lack of progress. In none of those emails, however, do either PG or KS accuse Potter of offering unfounded reassurances or otherwise misleading them.[34]

KS and PG testified generally about Potter's purported assurances, but their testimony failed to identify any specific instance when Potter offered an unfounded reassurance. KS testified that Potter "continually assured me that we were in good hands," that he went to Potter with "questions of a financial nature and to [get] some comfort . . . that things were going to be okay. . . ." But, KS continued, "I don't recall the exact substance of the conversations. I really don't." KS did not describe any conversation in which Potter offered a specific reassurance about anything, much less one that was unfounded. Moreover, KS admitted that, generally, his memory of the details surrounding the transaction was poor. KS said that he "made a decision a number of years ago to get on with my life and forget about it. So in terms of detail, I have lost a little of that. I have not stayed current with it. So I have to say I'm hazy on the details[.]"

PG's testimony was similarly non-specific. PG testified that, in late 2013 (i.e., after the bond power had expired), Potter "was assuring me that we shouldn't worry, that [RD] was credible, and that these were people we could trust," and "we shouldn't be concerned, that this was a legitimate situation. He's known [RD] for a long time, and that we should not be worried." PG did not identify any specific conversation in which Potter assured her about RD, or told her not to worry about something that she should have been worried about. That Potter vouched for RD is no surprise. Potter had done business with RD before and had known him for several years. There is no evidence that, to the extent that Potter vouched for RD at any time between 2013 and 2014, he had reason to believe, at that point in time, that RD was untrustworthy.

We cannot conclude from the record before us that Potter offered unfounded reassurances that caused PG and KS not to enforce the Developer's rights under the Agreement.

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[34] By contrast, in October 2014, after the Developer had hired Potter to sell the Shipping Note and Potter was not able to do so, PG wrote, "You have repeatedly assured us that you and [RD] are anxious to get this done as it is the only way you can make a commission. This has been going on for a long time."

2. Enforcement Failed to Establish that Potter Violated Rule 2010 by Refusing to Tell the Developer that He Had Retained a Portion of the Retainer or Where He Had Wired the Retainer

Enforcement alleged in its complaint that Potter acted unethically because, "[w]hen asked, Potter refused to tell [the Developer] that he had retained a portion of [the retainer], hindering [Developer's] attempts at recovery." There is no evidence in the record that the Developer ever asked Potter directly whether he had retained a portion of the retainer. Nevertheless, the Hearing Panel found Potter liable for violating FINRA Rule 2010 based on an email he sent to PG in October 2013. Around that time, a real estate broker apparently had placed "for sale" signs at the property. On October 15, 2013, PG emailed BV, KS, CS, and Potter about the signs.[35] Potter replied to PG:

> I receive over 50 emails a day on average[.] I do not have an interest financially in the transaction and do not need to be copied on everything going to [BV] or [RD]. I continue to be available to assist in facilitating communication between the parties and naturally if Europe has not responded to an item send it to me and I will do my best to get a response.

The Hearing Panel concluded that Potter's response to PG violated Rule 2010 because he "affirmatively misled PG when, as she sought his assistance in communicating with BV, he told her that he did 'not have an interest financially in the transaction.'" We disagree.

Potter's assertion that he lacked any financial interest in the transaction was not an effort to mislead PG. Potter was responding to PG's email about the "for sale" signs at the property. Potter was telling PG that he did not wish to receive a copy of every email she sent to BV or RD regarding the property. Moreover, Potter's assertion that he did not have an "interest in the transaction financially" was factually true in October 2013. Potter was not a party to the refinancing transaction and would not be affected financially regardless of whether the Financier settled the Developer's debt. Under the Agreement, if the Financier failed to settle the Developer's debt, the Financier was solely liable for returning $2 million to the Developer. Neither Meredith Financial nor Potter had any contractual liability for any part of the retainer.

Enforcement further alleged that Potter violated Rule 2010 because, "when asked, Potter refused to tell [the Developer] where he had wired $1.75 million of its [retainer], thereby hindering its attempts at recovery." The Hearing Panel found Potter liable for this alleged violation based on his failure to respond to KS's email inquiry in 2016. According to the Hearing Panel's decision, "when KS asked [Potter] directly for information about where he had wired portions of the retainer [in 2016], Potter's refusal to answer concealed from [the Developer] that he had not wired its funds to [the Financier] as he should have, but instead to RD and an entity unknown to [the Developer], and that he kept $250,000 for himself." Again, we disagree with the finding of violation.

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[35] PG's email is not in the record.

Enforcement failed to establish that Potter had an ethical duty to disclose to the Developer where he had wired the retainer. As discussed above, this was a commercial transaction between sophisticated entities. Meredith Financial did not owe a fiduciary duty to the Developer, nor did Meredith Financial have a relationship of trust and confidence with the Developer. Meredith Financial had no ethical duty to disclose information about the wire simply because the Developer wanted it.[36]

For these reasons, Enforcement failed to prove that Potter violated Rule 2010 by hindering the Developer's efforts to recover the retainer. We therefore reverse the Hearing Panel's finding of violation and dismiss this element of the complaint's allegations.

V. Conclusion

Enforcement failed to establish that Potter violated FINRA Rule 2010. We therefore reverse the Hearing Panel's findings of violation under the first and second causes of action, vacate the sanctions it imposed under both causes, and dismiss the complaint.

On Behalf of the National Adjudicatory Council,

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Jennifer Piorko Mitchell,
Vice President and Deputy Corporate Secretary

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[36] Meredith Financial had no contractual obligation to provide the information to the Developer or to assist the Developer in its efforts to recover the retainer from the Financier.