

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

SPENCER EDWARDS, INC.
(CRD No. 22067),

Respondent.

Disciplinary Proceeding
No. 2014041862701

Hearing Officer–CC

**EXTENDED HEARING PANEL
DECISION**

November 14, 2018

Member firm Respondent recommended and sold convertible two-year notes in a private placement to 13 customers without having a reasonable basis to believe that the investments were suitable for any investor. Respondent also distributed false, unbalanced, and misleading communications about the notes to potential investors. Respondent had inadequate written supervisory procedures in place and failed to adequately supervise due diligence conducted in connection with the notes. Furthermore, Respondent failed to transmit promptly to the issuer a customer check for investment in the note offering and, as a result, violated the Net Capital and Customer Protection Rules.

For this misconduct, the Extended Hearing Panel censures Respondent, fines the firm a total of \$495,000, suspends the firm in all capacities for 45 business days, orders the firm to offer rescission to the 13 customers who purchased the notes, imposes a six-month pre-use filing requirement for all of the firm’s communications with customers, and requires the firm to retain an outside consultant, acceptable to Enforcement, to review and revise the firm’s supervisory procedures.

Appearances

For the Complainant: Jeffrey P. Bloom, Esq., and Perry C. Hubbard, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondent: David A. Zisser, Esq., Jones & Keller, P.C.

DECISION

I. Introduction

Respondent, Spencer Edwards, Inc. (“Spencer Edwards”), recommended and sold to 13 customers two-year convertible notes totaling more than \$400,000 for Digi Outdoor Media, Inc. (“Digi”) without having a reasonable basis for making the recommendations. The firm conducted a minimal and inadequate due diligence investigation of the private offering and ignored red flags suggesting that further investigation was necessary before recommending the securities to its customers. Spencer Edwards also failed to supervise the firm’s suitability investigation and due diligence process, and the firm’s written supervisory procedures (“WSPs”) were not adequate. Furthermore, Spencer Edwards distributed to potential investors sales material related to the Digi offering that did not provide a fair and balanced presentation of information and was misleading. Finally, Spencer Edwards failed to promptly transmit to the issuer a customer check for investment in the Digi offering and, as a result, violated the Net Capital and Customer Protection Rules.

II. Procedural History

Enforcement filed a six-cause Complaint on December 4, 2017. Cause one alleges that, between September 2013 and August 2014, Spencer Edwards violated FINRA Rules 2111(a) and 2010 by conducting inadequate due diligence and ignoring red flags before recommending Digi notes to 13 customers who collectively purchased \$413,000 of the notes. Cause two alleges that Spencer Edwards violated FINRA Rules 2210 and 2010 by distributing to potential Digi investors misleading and incomplete sales materials prepared by Digi. Cause three alleges that Spencer Edwards violated NASD Rule 3010(a) and (b) and FINRA Rule 2010 by failing to adequately supervise the firm’s due diligence related to the Digi offering and maintaining inadequate WSPs.

Causes four, five, and six are related. Cause four alleges that Spencer Edwards willfully violated Securities Exchange Act of 1934 (“Exchange Act”) Rule 15c2-4(a) and FINRA Rule 2010 by failing to promptly transmit to Digi a customer check for the Digi offering. Specifically, cause four alleges that Spencer Edwards received a check for \$50,000 from customers GT and BT (“G & BT”) on or about September 24, 2013, but failed to transmit it to Digi until October 18, 2013. Cause five alleges that, during the period when Spencer Edwards held the customer check, the firm failed to maintain the required minimum net capital and willfully violated Exchange Act Rule 15c3-1 and FINRA Rule 2010. Cause five also alleges that Spencer Edwards operated pursuant to an exemption under Exchange Act Rule 15c3-3(k)(2)(ii) because, among other reasons, it did not hold customer funds or securities and therefore was required to maintain a minimum net capital of only \$100,000. Cause five further alleges that, by holding a customer check, the firm no longer qualified for a Rule 15c3-3(k)(2)(ii) exemption, and therefore it was required to maintain a minimum net capital of \$250,000, and failed to maintain that level of net capital. Cause six alleges that Spencer Edwards willfully violated Exchange Act Rule 15c3-3 and

FINRA Rule 2010 by failing to complete a customer reserve computation, which it was required to do when it no longer qualified for an exemption under Exchange Act Rule 15c3-3(k)(2)(ii).

Spencer Edwards denies the allegations contained in causes one through three of the Complaint. It denies that it failed to investigate the Digi note offering adequately before recommending note purchases to customers. It contends that the materials it provided to its customers, taken as a whole, were not misleading and they sufficiently disclosed risks related to the offering and that its supervisory systems and procedures were adequate. With respect to the allegations contained in causes four through six, Spencer Edwards contends it is uncertain when it received G & BT's check, but denies any wrongdoing and states that Enforcement failed to prove it held G & BT's check as alleged.

The parties participated in a three-day hearing in June 2018.

III. Facts

A. Spencer Edwards

Spencer Edwards has been a FINRA member firm since 1988.¹ The firm's main office is in Centennial, Colorado. Donna Flemming ("Flemming") joined the firm in 2003 as assistant to its then-owner, chief executive officer, and chief compliance officer Gordon Dihle ("Dihle").² The firm changed ownership in June 2012.³ At that time, Flemming assumed the positions of firm president, chief executive officer, and chief compliance officer.⁴ Flemming testified that she has also served as chief financial officer "for a long time," and resigned as chief compliance officer in September 2017.⁵ Currently, she is Spencer Edwards' president, chief executive officer, and chief financial officer.⁶ Spencer Edwards has never had more than 25 brokers associated with it at one time.⁷ In 2018, its primary business is stock liquidation.⁸

¹ Complainant's Exhibit ("CX-") 105, at 3. During the relevant period, Spencer Edwards' membership agreement with FINRA obligated the firm to operate pursuant to Rule 15c3-3(k)(2)(ii). Thus, according to Spencer Edwards' membership agreement, the firm was required to clear all transactions on a fully disclosed basis through its clearing firm and not hold customer funds or safe keep customer securities. CX-108, at 1.

² Transcripts of June 26-28, 2018 Hearing ("Tr.") 568-69.

³ Tr. 568.

⁴ Tr. 568-69; CX-105, at 3, 5.

⁵ Tr. 569. Flemming was chief compliance officer during the relevant period of September 2013 through August 2014.

⁶ Tr. 567-68; CX-105, at 5.

⁷ Tr. 584.

⁸ Tr. 584.

Shortly after Flemming became president, she hired Joseph Lavigne (“Lavigne”) to develop and head an investment banking department at Spencer Edwards.⁹ Steven Quoy (“Quoy”), a close acquaintance of Lavigne, joined Spencer Edwards shortly before Lavigne. Quoy originally was hired to establish a fixed income department at the firm, but that did not happen.¹⁰ Instead, he became the “capital markets guy” and worked with Lavigne in investment banking.¹¹ Quoy and Lavigne had worked together previously, and they shared accounts at Spencer Edwards.¹²

B. Spencer Edwards Develops an Investment Banking Department

Lavigne joined Spencer Edwards in August 2013 after friends who worked at the firm recruited him.¹³ When Lavigne joined Spencer Edwards, the firm did not have an investment banking department.¹⁴ Lavigne assumed the position of managing director of investment banking and reported to Flemming.¹⁵ At the time, Spencer Edwards’ process for approving participation in an offering was for Lavigne and Quoy to obtain Flemming’s approval after an informal presentation.¹⁶

Lavigne was responsible for conducting due diligence on investment banking deals at Spencer Edwards, and Quoy assisted him.¹⁷ Lavigne stated that Spencer Edwards relied on a checklist for conducting due diligence.¹⁸ He could not recall how he or the firm came to possess

⁹ Tr. 570-71. Lavigne left Spencer Edwards in January 2018. Tr. 42.

¹⁰ CX-117, at 19-20. At the hearing, Quoy testified that he suffered from an illness that interfered significantly with his ability to recall the events of 2013 and 2014. Tr. 365. As such, in lieu of Quoy’s hearing testimony, the parties agreed to enter into evidence the transcripts of Quoy’s June 18, 2015 and June 13, 2016 on-the-record testimony (“OTR”). *See* CX-117; CX-118.

¹¹ Tr. 49-50; CX-117, at 20.

¹² Tr. 48-49; CX-117, at 19, 27.

¹³ Tr. 42, 45. Before joining Spencer Edwards, Lavigne worked in an eight-person investment banking department at another member firm, but he did not lead that firm’s investment banking department. Tr. 44-45.

¹⁴ Tr. 46.

¹⁵ Tr. 42, 46.

¹⁶ Tr. 78-79.

¹⁷ Tr. 51. Lavigne testified extensively during the three-day hearing. He was unable to recall many details of his work on the Digi offering, but at the same time, was able to recall some facts in significant detail. Given the juxtaposition of Lavigne’s ability and inability to recall similar events from the same time, overall, we did not find Lavigne’s testimony particularly credible.

¹⁸ Tr. 263, 267-69; CX-38, at 3-10.

the due diligence checklist.¹⁹ Flemming testified that outside counsel, JS, also provided advice on due diligence.²⁰

Spencer Edwards eventually hired Edward Larkin (“Larkin”) in May 2014 as the managing director of corporate finance.²¹ Larkin had known Lavigne for many years, and Lavigne recruited him to join the firm.²² Larkin joined the firm to “oversee the operational aspect of the corporate finance effort.”²³ When he joined Spencer Edwards, Larkin determined that the firm’s compliance procedures relating to private placements needed improvement.²⁴

C. Digi Outdoor Media

Digi’s business plan was to install digital billboards in the Washington, D.C. metropolitan area.²⁵ Digi’s predecessor began as a single-member limited liability company in 2009,²⁶ and through reorganizations and a share exchange, ultimately developed from a limited liability company into a Nevada corporation.²⁷ At the time of Spencer Edwards’ sales of Digi notes, Digi Outdoor, LLC was the primary shareholder of Digi.²⁸ DM and DR controlled and owned Digi Outdoor, LLC.²⁹

Digi required substantial working capital to fund its digital billboard business. Digi disclosed, in connection with the note offering, that “[s]hortly following the completion of this \$1,000,000 note offering, [it would] need to undertake another round of financing in which [Digi] will seek to raise” \$10 million in order to fully implement its business plan.³⁰ Digi completed a merger with Placer Creek Mining Company on August 18, 2014.³¹ The merged entity publicly traded under Digi’s name.

¹⁹ Tr. 53-54; CX-117, at 33. Lavigne did not recall ever using the checklist to document the specific information he considered for due diligence or when he completed due diligence. Tr. 54. He merely used the checklist as guidance as to what information to review.

²⁰ Tr. 573.

²¹ Tr. 714-15.

²² Tr. 715, 717.

²³ Tr. 717.

²⁴ Tr. 717-19.

²⁵ Tr. 55.

²⁶ CX-42, at 5.

²⁷ Tr. 215; CX-42, at 5.

²⁸ Tr. 215-16.

²⁹ Tr. 216.

³⁰ CX-28, at 58.

³¹ Tr. 77-78, 205; CX-42, at 5.

DM, DR, and SD were the principals of Digi who operated the company.³² DM was Digi's founder. In late 2013, DM served as Digi's president and chief executive officer.³³ DM claimed to have had more than 20 years of experience in the outdoor advertising industry.³⁴ DR was the chairman of Digi's board. He was a businessperson with claimed expertise in mergers, acquisitions, strategic planning, and investor relations.³⁵ SD was a certified public accountant who claimed more than 20 years of financial and tax experience. He served as Digi's chief financial officer.³⁶

Prior to the Digi note offering, investors in Digi's predecessor companies sued DM and SD twice and settled both actions.³⁷ LexisNexis reports UCC and tax liens filed against Digi, its parent company, and its principals during the years immediately preceding the Digi private placement.³⁸ After the Digi private placement, DM and SD were indicted on criminal charges, and the Securities and Exchange Commission ("SEC") charged them civilly with securities fraud related to a Digi offering.³⁹

D. The Principals of Digi Pique Lavigne's Interest in the Company

In 2009, Digi's principals attempted unsuccessfully to raise funds to develop a digital billboard business.⁴⁰ Lavigne had known DR since high school in the mid-1980s and trusted him completely.⁴¹ Lavigne met DM in 2008 and SD shortly thereafter.⁴² They talked to Lavigne in 2009 about launching a business focused on installing digital billboards around Washington, D.C.⁴³ Although Lavigne was associated with a member firm at that time, he did not believe he would be successful at raising capital for the venture.⁴⁴ Lavigne testified that Digi's outdoor sign business went nowhere in 2009.⁴⁵

³² Tr. 56.

³³ CX-17, at 2.

³⁴ CX-17, at 2.

³⁵ CX-17, at 2.

³⁶ CX-17, at 2.

³⁷ Tr. 631-36, 666-68; CX-98; CX-99; CX-100; CX-101.

³⁸ Tr. 640-42; CX-20, at 15-22; CX-21, at 29-34; CX-22, at 4-6.

³⁹ Tr. 341-42, 663-65.

⁴⁰ Tr. 58-59, 61.

⁴¹ Tr. 56-57, 367-69.

⁴² Tr. 56-57.

⁴³ Tr. 59-61.

⁴⁴ Tr. 60-61.

⁴⁵ Tr. 61. Larkin too was familiar with Digi's earlier efforts to start a digital sign business. Larkin testified that he met the principals of Digi while associated with another member firm. Tr. 722-27. At that time, he was not

Lavigne encountered DR, DM, and SD in the summer of 2013 when they were again seeking financing for Digi’s digital billboard business.⁴⁶ DR and DM presented information to Lavigne about Digi’s business prospects and plan of operation, and Lavigne determined that he wanted to help Digi obtain financing.⁴⁷ At the time, Lavigne had not yet joined Spencer Edwards. Lavigne knew that Digi wanted to raise \$1 million in a private placement and that it planned to raise some of the money on its own.⁴⁸ Lavigne stated that there was “some activity going on in the space,” and another issuer with a similar business model was doing well and preparing to go public.⁴⁹ He concluded that the Digi private placement would be a good deal to bring with him to Spencer Edwards to start the firm’s new investment banking department.⁵⁰

From the start of the Digi private placement, Lavigne knew that Digi was planning to become a publicly traded company in the future, possibly through a merger with a public company.⁵¹ Lavigne learned in August or September 2013 that one possible merger candidate was Placer Creek Mining Company, a company controlled by Lavigne’s brother, ML.⁵² Lavigne did not mention his brother’s involvement with Placer Creek Mining Company to Flemming or anyone else at Spencer Edwards before or during the Digi offering.⁵³

E. The Terms of the Digi Offering

The private placement was originally a \$1 million “best efforts” offering of subordinated convertible promissory notes. The offering had no minimum requirement and claimed an exemption from registration under the Securities Act of 1933.⁵⁴ The notes accrued interest at 25 percent per annum, and all unpaid principal and accrued interest was due and payable two years after the date of issuance of each note, unless the note was converted to equity.⁵⁵ In the thirteenth

interested in getting involved in financing Digi’s proposal to install digital billboards in Washington, D.C. Tr. 727-32. He questioned whether Digi would be successful because “there ha[d] not been digital advertising in Washington, D.C., before,” and he noted that digital advertising in Washington, D.C. was and is the subject of ongoing court battles. Tr. 729-30.

⁴⁶ Tr. 60-62.

⁴⁷ Tr. 70-72.

⁴⁸ Tr. 66-69.

⁴⁹ Tr. 67-68.

⁵⁰ Tr. 70-71, 385.

⁵¹ Tr. 77.

⁵² Tr. 78, 205-06, 279, 337.

⁵³ Tr. 206-07.

⁵⁴ CX-18. The offering amount subsequently increased to \$1.5 million. Tr. 74, 323. Spencer Edwards began generally using a copy of the Digi Note Purchase Agreement reflecting the increase in March 2014. Tr. 323.

⁵⁵ Tr. 56; CX-18, at 2.

month after issuance and prior to conversion, note holders were entitled to a pro rata portion of Digi's net revenues. Revenues paid were to be subtracted from accrued interest.⁵⁶

F. Spencer Edwards' Due Diligence for the Digi Outdoor Media Offering

Once Lavigne joined Spencer Edwards, he quickly moved forward with the Digi offering. As of August 15, 2013, Digi had provided Lavigne with a final term sheet for the Digi offering.⁵⁷ Lavigne testified that, by August 20, 2013, Spencer Edwards had decided to participate in the Digi private placement offering.⁵⁸ He sent Digi principals DM and DR Spencer Edwards' investment banking agreement on August 20, 2013.⁵⁹

Lavigne was responsible for Spencer Edwards' due diligence for the Digi offering, and Flemming supervised his work.⁶⁰ When Lavigne began the firm's due diligence in August 2013, he had been with the firm for a few weeks and had never before supervised due diligence for an offering.⁶¹ Lavigne testified that he began his investigation of Digi when he attended a conference in Colorado Springs that included presentations from several issuers including DM on behalf of Digi.⁶² Thereafter, Spencer Edwards' due diligence included reviewing the documents that Digi provided the firm by way of an electronic dropbox (hereafter, "the Dropbox").⁶³

1. Leases for Signage Space

The ability to lease signage space in high traffic areas was central to Digi's business model and a selling point communicated to potential investors.⁶⁴ Lavigne testified that, during due diligence, Digi had represented it could get signed leases in place "fairly quickly" once

⁵⁶ CX-18, at 2.

⁵⁷ Tr. 73-74; CX-1. The term sheet described an offering of up to \$1 million of convertible subordinated promissory notes, in which each investor must invest a minimum of \$50,000 (although Digi reserved the right to accept a smaller amount). Tr. 76-77; CX-1, at 2. It stated that all unpaid principal and accrued interest would be due and payable two years from the date of issuance unless the note holder converts to equity securities. CX-1, at 2. It also stated that the notes would pay interest at the rate of 25 percent per year and that, in lieu of fixed monthly interest payments, the note holder was entitled to receive a pro rata portion of Digi's gross revenues. CX-1, at 2.

⁵⁸ Tr. 80, 93.

⁵⁹ Tr. 92-94; CX-2.

⁶⁰ Tr. 88-89. Lavigne stated that he gave Flemming information on Digi as he collected it. Flemming, however, testified that although she maintained a file for the Digi note offering, she did not know what was in it. Tr. 590-91. Lavigne also stated that Flemming had no role "on the due diligence side," but he testified that he ultimately reported to her. Tr. 334.

⁶¹ Tr. 336.

⁶² Tr. 400-05.

⁶³ Tr. 83.

⁶⁴ See CX-27.

money started coming in.⁶⁵ He stated that the firm did nothing to document or prove this assertion, and he relied almost exclusively on the representations of DM and his long-time friend DR.⁶⁶

Throughout this proceeding, Spencer Edwards contended it knew and disclosed to customers that Digi did not have executed leases during the offering.⁶⁷ But Lavigne's testimony about whether and when Digi obtained signed leases during the offering was inconsistent. First, Lavigne contended that, as part of Spencer Edwards' due diligence, he did not see signed leases.⁶⁸ He said that Digi showed Spencer Edwards only unsigned, sample leases for entities related to Digi.⁶⁹ He testified that Digi "gave us a list of a number of properties that they were going to try and sign up."⁷⁰ Spencer Edwards never endeavored to confirm the list by talking to potential landlords.⁷¹

After first testifying that Digi did not have any signed leases during the offering, Lavigne reversed course. He testified that, at some point during the offering, Digi did represent that it had signed leases in place.⁷² He could not recall if or when he saw signed leases.⁷³ He also testified, however, "[w]e did at some point get some signed leases, yes."⁷⁴ He stated that the timing might have been after the offering was completed, but as with much of Lavigne's testimony, he could not recall for sure.⁷⁵ Conversely, Lavigne also testified that, sometime around March 2014, he learned that Digi had signed some leases.⁷⁶ In a series of emails with Digi's principals in September 2014, Larkin tried to determine if Digi had signed any leases for electronic billboard

⁶⁵ Tr. 84.

⁶⁶ Tr. 85.

⁶⁷ Answer ("Ans.") ¶¶ 45, 47, 49, 52, 54-56, 64-65.

⁶⁸ Tr. 122-23, 145. Lavigne testified that Spencer Edwards made several requests of Digi for copies of signed leases. Tr. 123-25. Lavigne stated that Digi's answer to his requests was, "[W]e'll get them to you," but it was unclear when and if he saw signed leases before Larkin's arrival at the firm. He did not document Spencer Edwards' requests or Digi's responses. Tr. 125.

⁶⁹ Tr. 82, 122-23, 130-36, 143-44; CX-5; CX-6; CX-7; CX-8; CX-9; CX-10; CX-11; CX-12; CX-13; CX-14; CX-15; CX-16.

⁷⁰ Tr. 126.

⁷¹ Tr. 126-27. Lavigne stated that Digi did not want Spencer Edwards to talk to potential landlords (for digital billboard leases) because it was concerned about information being shared with its competitors. Tr. 127. Spencer Edwards did not probe this concern with Digi or ask Digi to identify the purported competitors that concerned it. Tr. 127-29.

⁷² Tr. 123.

⁷³ Tr. 124.

⁷⁴ Tr. 159.

⁷⁵ Tr. 159.

⁷⁶ Tr. 292.

space.⁷⁷ The first Larkin heard of signed leases was in January or February 2014.⁷⁸ Lavigne testified that he did not know how many executed leases Digi had and which properties they secured until Larkin intervened toward the end of the offering.⁷⁹

Digi included in the Dropbox a spreadsheet titled “Digi DC Construction.”⁸⁰ The spreadsheet listed locations and information about signs at those locations.⁸¹ It included a column titled “Lease in Place,” and an “x” in that column for some of the locations listed.⁸² The Dropbox included a second spreadsheet similar in content to the first, titled “Digi DC Lease Tracking.”⁸³ Lavigne could not recall if he reviewed this document, although he testified that, “for the most part,” he looked at every document in the Dropbox.⁸⁴ Lavigne purported to have no understanding of either spreadsheet and claimed not to recall whether he discussed them with anyone at Digi.⁸⁵

2. Permits for Sign Construction

Lavigne understood that Digi needed to obtain permits to erect digital billboards.⁸⁶ He could not recall specifically what Digi had to do to secure the permits or whether the company had to have leases in place before obtaining permits.⁸⁷ He stated that he may have asked DM these details, but he could not recall.⁸⁸ Lavigne did not even know whether Digi had obtained any permits during the offering and, if they had, how many they had secured.⁸⁹

⁷⁷ Tr. 746-48. Larkin testified that, after numerous requests, he was able to get DM to provide copies of executed leases. He testified, “[A]fter a lot of wailing and pulling of teeth by myself, there was probably four or five phone calls involved And then after more delays, eventually stuff started showing up.” Tr. 721-22.

⁷⁸ Tr. 741.

⁷⁹ Tr. 329. Indeed, Lavigne testified that he could not recall ever seeing Digi’s March 18, 2014 executed lease for billboard space in Washington, D.C., even though Digi entered the lease while the offering was ongoing. Tr. 329-30.

⁸⁰ CX-23.

⁸¹ Tr. 145-48; CX-23.

⁸² Tr. 145-48; CX-23.

⁸³ CX-24. This spreadsheet also included a column for rent expected per month. Some of the entries suggested that the amounts were guaranteed. CX-24.

⁸⁴ Tr. 164-65.

⁸⁵ Tr. 165-70.

⁸⁶ Tr. 140.

⁸⁷ Tr. 140.

⁸⁸ Tr. 140-41.

⁸⁹ Tr. 141. During on-the-record testimony prior to the hearing, however, Lavigne testified that Digi had already secured permits for 50 percent of its billboard locations and had started “preconstruction” on signs. Tr. 141. Lavigne could not recall if he ever saw evidence of the permits. Tr. 142. Lavigne also could not recall if he ever asked Digi if it had signed leases for the locations for which it had started “preconstruction” of signs. Tr. 142-43. Lavigne also did

3. PowerPoint Presentations

Spencer Edwards saw two different PowerPoint presentations (both prepared by Digi) as part of its due diligence for the Digi notes. One presentation was dated “Q1 2013,” and the other was dated “Q3 2013.”⁹⁰ Lavigne recognized that the Q1 2013 slide deck did not appear to apply to the Digi note offering, but never asked Digi why it was included in the Dropbox for the note offering.⁹¹ Nor did Lavigne question Digi as to the contents of the slide deck, including statements that he believed to be untrue. For example, Spencer Edwards contends it knew during the offering Digi had “no leases in place,” but Lavigne never asked about the representation in the Q1 2013 slide deck that there were “protected lease agreements in place.”⁹² Lavigne was unaware of any locations where Digi was installing digital billboards, yet he never asked about the statement, “Currently building out multiple lease locations with additional lease agreements drafted and waiting.”⁹³

4. Signage Sites

Between October 21 and 23, 2013, Lavigne and Quoy met DM, DR, and SD in Washington, D.C. to see Digi’s proposed signage sites.⁹⁴ Although they visited sites, Lavigne did not believe that signed leases were in place for the sites, and they did not meet with any property owners for purported sign locations.⁹⁵ Lavigne claimed that he understood at that point that Digi was “starting negotiating” leases.⁹⁶ During the visit, Lavigne never attempted to match up the property locations that DM and DR showed him to the locations listed on the spreadsheets in Digi’s Dropbox.⁹⁷ During the visit, Quoy and Lavigne did not see any sites where digital signs had been installed or where sign placement was imminent.⁹⁸ They also made no effort to confirm

not know if Digi could conduct pre-lease preparatory work or if a signed lease had to be in place before Digi could begin installation. Tr. 136, 140-42.

⁹⁰ Tr. 226-35; CX-26; CX-27. The cover page for the Q1 2013 PowerPoint presentation said, “Digi Outdoor LLC” and “Currently Seeking US \$10MM Preferred Equity Opportunity.” CX-26, at 1. The Q3 2013 presentation cover page said, “Digi Outdoor Media” and “Currently Seeking Financing.” CX-27, at 1. Both were in the Dropbox.

⁹¹ Tr. 235-36.

⁹² Tr. 235-36; CX-26, at 2.

⁹³ Tr. 236; CX-26, at 2.

⁹⁴ Tr. 149.

⁹⁵ Tr. 149-50, 155-56.

⁹⁶ Tr. 154.

⁹⁷ Tr. 170

⁹⁸ Tr. 244. This contrasts with the Q3 2013 PowerPoint presentation that Spencer Edwards used to sell the Digi notes. Tr. 236-37; CX-27. The Q3 2013 PowerPoint deck suggested that signage sites were secured and ready for signs to be erected. *See* CX-27, at 2-3.

that any of the sites they viewed were actually available to be leased by Digi. Rather, they relied solely on DM's representations.⁹⁹

5. Corporate History

As part of Spencer Edwards' due diligence, Lavigne claimed to have reviewed Digi's corporate history, but he could not recall specifically what he learned regarding its parent company and shareholders.¹⁰⁰ Quoy suggested to Lavigne that he send Digi's due diligence documents to Spencer Edwards' outside counsel, JS, for review.¹⁰¹ JS reviewed the materials provided by Digi and recommended that Spencer Edwards obtain additional materials.¹⁰² It is unclear from the firm's due diligence file how much of the additional materials JS requested the firm actually obtained.

6. Digi Investment Banking Agreement

DM signed the investment banking agreement for Digi on August 22, 2013; Flemming signed it for Spencer Edwards on September 11, 2013.¹⁰³ The evidence as to whether Spencer Edwards had completed due diligence when Flemming signed the agreement is inconsistent. Lavigne testified that he did not know if the firm had completed its due diligence investigation when Flemming signed.¹⁰⁴ In contrast, Spencer Edwards' response to a FINRA Rule 8210 request for information stated that Lavigne had "approved the due diligence finding" before Spencer Edwards signed the investment banking agreement.¹⁰⁵ When Lavigne reviewed Spencer Edwards' Rule 8210 response, he changed his testimony and stated that it was indeed accurate and that he had in fact completed the firm's due diligence.¹⁰⁶ In other testimony, however, both Lavigne and Quoy stated that the firm had not completed its due diligence before selling Digi notes and that due diligence was "ongoing" when the firm started selling Digi notes.¹⁰⁷

G. Spencer Edwards' Sales of Digi Notes

Lavigne and Quoy met with representatives of Spencer Edwards regarding the Digi note offering in mid-September 2013.¹⁰⁸ They provided Spencer Edwards' registered representatives

⁹⁹ Tr. 252-53.

¹⁰⁰ Tr. 187-88.

¹⁰¹ Tr. 95; CX-3.

¹⁰² Tr. 96.

¹⁰³ Tr. 98-100; CX-4.

¹⁰⁴ Tr. 100-01.

¹⁰⁵ Tr. 102-03; CX-90, at 4.

¹⁰⁶ Tr. 102-03; CX-90, at 4.

¹⁰⁷ Tr. 335; CX-117, at 73.

¹⁰⁸ Tr. 115-16, 432.

with a variety of materials, including financial models and funding information for Digi DC LLC, Digi Worldwide, and Digi; a document titled “Digi Outdoor Media, Inc. Summary Terms of the Offering”; the Digi Note Purchase Agreement; and a second document (with different content) titled “Digi Outdoor Media, Inc. Summary Terms of the Offering.”¹⁰⁹ The firm’s representatives began soliciting purchases of the Digi notes in September 2013, and the firm approved the first purchase transaction on October 18, 2013.¹¹⁰

Lavigne testified that Spencer Edwards’ selling point for the Digi notes was the beneficial 25 percent return, based on the firm’s belief that Digi would be able to generate the revenues necessary to pay the return.¹¹¹ Lavigne also considered the opportunity to convert the notes to stock as a selling point because Digi intended eventually to go public.¹¹² Lavigne understood that Digi would begin building and installing signs once money from the offering came in, and that that would occur quickly enough to pay off the notes.¹¹³

Lavigne, Quoy, and other Spencer Edwards registered representatives sent potential investors a variety of materials related to the Digi note offering, including some or all of the following:

1. a Q3 2013 PowerPoint printout;
2. a document titled “Summary Terms of the Offering”;
3. a two-page information sheet titled “Digi Outdoor Media, Inc.” and marked “Confidential – Not for Circulation – August, 2013”;
4. a Subordinated Convertible Promissory Note;
5. a Note Purchase Agreement;
6. Addendum A to the Note Purchase Agreement, titled “Terms of the Offering” (the contents of which differed from the document titled “Summary Terms of the Offering”);
7. Addendum B to the Note Purchase Agreement, titled “Risk Factors”;
8. Addendum C to the Note Purchase Agreement, titled “Form of Convertible Promissory Note” but otherwise blank;

¹⁰⁹ Tr. 432-40; Respondent’s Exhibit (“RX-”) 12.

¹¹⁰ Tr. 103, 534, 542; CX-28; CX-29; CX-30; CX-44; CX-61.

¹¹¹ Tr. 208. Quoy also testified that the 25 percent return was Spencer Edwards’ main selling point, but noted that the conversion option was an important component as well because it provided investors with an exit strategy. CX-117, at 93.

¹¹² Tr. 389-90.

¹¹³ Tr. 208.

9. Addendum D to the Note Purchase Agreement, titled “Digi Outdoor Media, Inc. 2013 Executive Summary,” which included a two-paragraph disclaimer regarding forward-looking statements, but was otherwise blank;
10. a document simply titled “Digi Outdoor Media, Inc. – The Opportunity” and dated August 2013; and
11. a variety of financial information for Digi and its related entities.¹¹⁴

Although some of these documents were marked “Confidential – Not for Circulation,” Spencer Edwards nonetheless distributed them to customers. Lavigne could not be sure that every potential investor received the same materials. He stated that he sometimes changed the mix of documents he sent to potential investors.¹¹⁵

In December 2013, Spencer Edwards sponsored two investor conferences for the Digi offering, one in Boulder and one in Denver.¹¹⁶ Lavigne and other members of the firm invited potential investors. DM and DR attended and presented the Q3 2013 PowerPoint slide deck and other information on behalf of Digi.¹¹⁷ Digi provided documents for investors to take away, and the Digi Note Purchase Agreement was available for investors.¹¹⁸ Spencer Edwards had account applications available as well.¹¹⁹ Several attendees actually invested in the Digi note offering and many were new customers to Spencer Edwards.¹²⁰ After these two investor conferences, Spencer Edwards’ representatives, including Lavigne, reached out to additional potential investors who could not attend the conferences.¹²¹

Between September 2013 and August 2014, Spencer Edwards recommended and sold the Digi notes to 13 investors who invested a total of \$413,000.¹²² Spencer Edwards received a ten percent fee on the sales, and the selling representatives received 80 percent of the firm’s earnings.¹²³ The Lavigne/Quoy sales team sold the vast majority of the notes Spencer Edwards

¹¹⁴ See Tr. 104-15, 118-20, 237, 247, 277-88, 290-96, 343-51; CX-17; CX-28; CX-29; CX-30; CX-32; CX-33; CX-34; CX-35.

¹¹⁵ Tr. 120.

¹¹⁶ Tr. 273.

¹¹⁷ Tr. 275-77.

¹¹⁸ Tr. 275-76.

¹¹⁹ Tr. 276.

¹²⁰ Tr. 276.

¹²¹ Tr. 277.

¹²² Tr. 671-76; CX-115.

¹²³ Tr. 676; CX-115.

sold.¹²⁴ Registered representatives Richard Seefried (“Seefried”) and Brenton Bataille (“Bataille”) were responsible for three of the thirteen sales.¹²⁵

H. Check from Customers GT and BT

Bataille sold a Digi note to customers G & BT in September 2013 for a total of \$50,000.¹²⁶ G & BT signed the Digi Note Purchase Agreement on September 24, 2013, and submitted it to Spencer Edwards along with a check for \$50,000 dated September 24, 2013.¹²⁷ Bataille never saw the \$50,000 check that accompanied the agreement, but the firm advised him that it had received the check.¹²⁸ At that time, G & BT had been firm customers for more than ten years, so Flemming directed Bataille to obtain an updated account form for the customers to ensure their suitability for the investment.¹²⁹ Spencer Edwards received a signed and updated new account form on October 1, 2013.¹³⁰

Lavigne testified that he was aware that the firm delayed G & BT’s investment while Bataille obtained additional or updated information from them.¹³¹ He further testified that he had “no idea where the check was or if [Spencer Edwards] had the check.”¹³² In a series of emails between October 12 and 15, 2013, Lavigne appeared to know that the firm had received G & BT’s check, and he responded to Digi’s inquiries about the check.¹³³ On or after October 18, 2013, Spencer Edwards sent G & BT’s documentation and check for the purchase of a Digi note to Digi.¹³⁴

¹²⁴ CX-115.

¹²⁵ Tr. 497-98; CX-115. Seefried sold Digi notes to two customers who both knew Digi principal DR for many years before their note purchases. Tr. 499. Seefried also knew DR. Tr. 499. He testified that both customers remain close friends of his. Tr. 518-19. Seefried testified that his trust in DR played a role in his willingness to sell Digi notes to his customers. Tr. 507. Seefried independently visited Washington, D.C., to conduct his own due diligence, but mainly relied on the firm’s due diligence investigation. Tr. 503-04, 511.

Bataille sold a Digi note in September 2013 to a couple who had been his customers for more than ten years. Tr. 537. Digi was the first private placement that Bataille had ever recommended to these customers. Tr. 534. Bataille conducted some investigation into the Digi notes but, like Seefried, mainly relied upon Spencer Edwards for due diligence. Tr. 559.

¹²⁶ Tr. 534; CX-48, at 39-40.

¹²⁷ CX-48, at 11.

¹²⁸ Tr. 537.

¹²⁹ Tr. 537-38.

¹³⁰ Tr. 550-60, 590; CX-48, at 39-41.

¹³¹ Tr. 309-10.

¹³² Tr. 310.

¹³³ CX-45.

¹³⁴ Tr. 313-24; CX-44, at 13; CX-46.

Flemming's testimony about G & BT's check suggests that the firm's procedure for handling customer checks was in disarray. Flemming stated that the truth is she has no idea what happened to the check or how long the firm held it.¹³⁵ Flemming identified a person who she surmised was responsible for opening the mail, but stated that she did not know what that person was supposed to do with the check.¹³⁶ Flemming was chief financial officer and financial and operations principal at the time, but never tried to investigate the firm's conduct with respect to holding G & BT's check.¹³⁷

I. Spencer Edwards' Supervisory Policies and Procedures

1. Spencer Edwards' WSPs

Spencer Edwards' WSPs dated August 2013 stated, in the section titled "Due Diligence Review," that the firm "shall undertake adequate due diligence review of all offering and offering documents in which it participates."¹³⁸ It stated that due diligence review was the responsibility of owner and chief executive officer Dihle and/or the chief compliance officer.¹³⁹ Although Dihle did not leave Spencer Edwards until in or around November 2013, Flemming testified that she assumed the positions of president and chief compliance officer around the time of the Digi offering and never consulted with Dihle about Digi.¹⁴⁰ The August 2013 WSPs also stated that, for each offering, Spencer Edwards must meet "a set of minimum standards" in order to participate.¹⁴¹ The WSPs stated that Dihle and/or the chief compliance officer will maintain files reflecting the due diligence engaged in by the firm, and provided a list of items that may or may not be included in the due diligence file.¹⁴²

The Due Diligence section of Spencer Edwards' WSPs did not change until the November 2013 WSPs.¹⁴³ This version of the WSPs stated that the firm's due diligence review was the responsibility of outside counsel and/or the chief compliance officer.¹⁴⁴ This version did not mention Lavigne.¹⁴⁵ All else remained unchanged. Although the firm revised the WSPs

¹³⁵ Tr. 609.

¹³⁶ Tr. 609.

¹³⁷ Tr. 610-11.

¹³⁸ Tr. 588; CX-78, at 12.

¹³⁹ CX-78, at 12.

¹⁴⁰ Tr. 577.

¹⁴¹ CX-78, at 12.

¹⁴² CX-78, at 12 (stating that "[s]uch due diligence may include one or more of the following" documents from the provided list).

¹⁴³ Tr. 592-93.

¹⁴⁴ CX-80, at 12.

¹⁴⁵ Tr. 593.

seven times, the WSPs' Due Diligence section did not change during the entire course of the offering. In the August 2014 WSPs, the Due Diligence section stated, "Due Diligence review shall be the responsibility of outside counsel and/or the [chief compliance officer]."¹⁴⁶ The firm still had not added Lavigne's name.

2. Supervision of the Digi Offering

When Spencer Edwards started selling Digi notes, the firm's process for approving participation in an offering was for Lavigne and Quoy to obtain Flemming's approval after an informal presentation.¹⁴⁷ Flemming, however, stated that although she was "technically" Lavigne's supervisor, she did very little to supervise him because she had no role in investment banking and knew nothing about it.¹⁴⁸ Flemming testified that she was not involved in approving the Digi offering. She stated, "I signed the agreement as president of the firm. That was it."¹⁴⁹ She claimed that she relied on the firm's outside counsel, JS, to "advise" the firm's investment banking department.¹⁵⁰

It is not clear whether Spencer Edwards had a system in place to review sales and marketing materials. Flemming testified that investment banking was the only department at Spencer Edwards that used marketing materials.¹⁵¹ As to whether the firm had a process for review and approval, Flemming stated, "No. I think there's something about it [in the firm's procedures], but it's not an occurrence at our firm."¹⁵² Conversely, Lavigne testified that it was his understanding that Flemming had the authority to approve sales and marketing materials, although he claimed not to know for sure which items had been approved for the Digi offering.¹⁵³ Flemming also testified that she did not know if the firm's procedures required Lavigne to evidence his review of sales materials that associated persons used to sell the Digi

¹⁴⁶ CX-81, at 12; CX-82, at 12; CX-83, at 12; CX-84, at 12; CX-85, at 12; CX-86, at 12; CX-87, at 12; CX-88, at 12. Flemming testified, "I don't know how that happened, because I thought that it had been changed," to mention Lavigne. Tr. 596.

¹⁴⁷ Tr. 78-79. Digi was Spencer Edwards' first private placement. After the Digi offering, the approval process developed into a more formal presentation to an investment banking committee. Tr. 78-79; CX-117, at 70.

¹⁴⁸ Tr. 571-72.

¹⁴⁹ Tr. 574.

¹⁵⁰ Tr. 572-74.

¹⁵¹ Tr. 582.

¹⁵² Tr. 582. She further stated, "There could have been something in the supervisory procedures, but it wasn't something we utilized because we didn't do it." Tr. 582.

¹⁵³ Tr. 239-40.

offering.¹⁵⁴ She stated that Spencer Edwards hired Larkin to enhance the firm’s supervisory procedures.¹⁵⁵

IV. Findings of Violation

A. Cause One – Lack of Reasonable-Basis Suitability

Cause one of the Complaint alleges that Spencer Edwards recommended the purchase of Digi notes to 13 customers without a sufficient understanding of the status of leases or lease commitments for Digi signs and other aspects of Digi’s business. Cause one further alleges that Spencer Edwards recommended Digi notes before the firm had completed its due diligence. It also alleges that Spencer Edwards failed to identify and investigate inconsistencies and inaccuracies in materials provided by Digi. It alleges that Spencer Edwards failed to identify and investigate litigation and liens related to officers and predecessors of Digi that could impact Digi’s assets. In addition, it alleges that the firm failed to question a missing executive summary from the Digi Note Purchase Agreement that Digi drafted, and it also alleges that the firm did not adequately investigate and address Digi’s corporate status and whether its SEC filings were current. Cause one alleges that, given these facts, Spencer Edwards did not have a reasonable basis to believe the recommendation of Digi notes was suitable for any investor. Consequently, Spencer Edwards’ recommendation of the notes violated FINRA Rules 2111(a) and 2010.

Spencer Edwards’ primary defense to these allegations is that the firm and its customers knew there were no leases in place when it sold Digi notes and that the Digi Note Purchase Agreement included sufficiently extensive risk disclosures.¹⁵⁶

FINRA Rule 2111(a) states that a member must have a reasonable basis to believe that a recommended transaction or investment strategy is suitable for the customer. Rule 2111 consists of three main obligations: customer-specific suitability, quantitative suitability, and reasonable-basis suitability.¹⁵⁷ The Complaint alleges that Spencer Edwards violated the reasonable-basis suitability obligation. “The reasonable-basis obligation requires a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least *some* investors.”¹⁵⁸ What constitutes reasonable diligence varies depending on, among other factors, the complexity of and risks associated with the security and the

¹⁵⁴ Tr. 585.

¹⁵⁵ Tr. 585.

¹⁵⁶ Ans. ¶¶ 45, 47, 49, 52, 54-55, 61, 63-65.

¹⁵⁷ FINRA Rule 2111, Supplementary Material 2111.05. *See also F. J. Kaufman & Co. of Va.*, 50 S.E.C. 164, 168 n.18 (1989) (finding that a recommendation implies that a dealer has a reasonable basis to make it and, as a prerequisite, has undertaken a reasonable investigation) (citation omitted).

¹⁵⁸ FINRA Rule 2111, Supplementary Material 2111.05(a); *see also Michael Frederick Siegel*, Exchange Act Release No. 58737, 2008 SEC LEXIS 2459, at *28 (Oct. 6, 2008) (holding that, before making a customer-specific suitability determination, the member firm must have a reasonable basis for believing the recommendation is suitable for at least some customers), *aff’d in relevant part*, 592 F.3d 147 (D.C. Cir. 2010).

member's familiarity with the security.¹⁵⁹ The member's reasonable diligence must provide the member with an understanding of the potential risks and rewards associated with the recommended security.¹⁶⁰

Indeed, FINRA has reminded its members, in the context of offerings like the Digi note private placement, of the following suitability requirements:

In order to ensure that it has fulfilled its suitability responsibilities, a [member firm] . . . should, at a minimum, conduct a reasonable investigation concerning:

- the issuer and its management;
- the business prospects of the issuer;
- the assets held or to be acquired by the issuer;
- the claims being made; and
- the intended use of proceeds of the offering.¹⁶¹

Furthermore, “[w]hen presented with red flags, the [member firm] must do more than simply rely upon representations by issuer’s management, the disclosure in an offering document or even a due diligence report of issuer’s counsel.”¹⁶²

Before recommending the Digi offering to customers, Spencer Edwards was required to conduct an independent investigation of Digi’s business plans, operations, principals, financial situation, and the viability of its business prospects, particularly with respect to the prospects for securing lease agreements.¹⁶³ We find that Spencer Edwards failed to adequately investigate red flags and understand the Digi offering before selling Digi notes.

¹⁵⁹ FINRA Rule 2111, Supplementary Material 2111.05(a).

¹⁶⁰ *Id.* See also *Siegel*, 2008 SEC LEXIS 2459, at *28 (holding that the reasonableness of a recommendation is predicated on an understanding of the potential risks and rewards inherent in that recommendation); *Dep’t of Enforcement v. Gomez*, No. 2011030293503, 2018 FINRA Discip. LEXIS 10, at *34 (NAC Mar. 28, 2018) (“For a recommendation involving the private placement of securities, a registered representative should conduct reasonable diligence of the issuer and the individuals involved with it; the issuer’s purported business and prospects; the assets the issuer claims to hold or intends to acquire; any claims made about the securities at issue; and the handling and use of the offering’s proceeds.”).

¹⁶¹ FINRA Regulatory Notice 10-22, at 5 (Apr. 2010), <http://www.finra.org/industry/notices/10-22> (citations omitted).

¹⁶² FINRA Regulatory Notice 10-22, at 6.

¹⁶³ See FINRA Regulatory Notice 10-22, at 9 (requiring member firms to conduct a reasonable investigation of the issuer’s business prospects and the relationship of those prospects to the proposed price of the security).

1. Spencer Edwards Failed to Identify and Investigate Inconsistencies Regarding Digi's Lease Commitments

Because the firm sold Digi notes as an investment that would pay 25 percent, the firm had to determine if it was realistic to believe that Digi could generate the revenue necessary to make the required payments. Digi would succeed only if it secured leases to erect signs in well-traveled areas of Washington, D.C.¹⁶⁴ The ability to lease signage space in high-traffic areas was central to Digi's business model. Yet Spencer Edwards had little information on this topic and conducted no independent investigation. In some instances, it received conflicting information from Digi, but did not probe Digi to resolve these inconsistencies. Instead, Spencer Edwards relied almost exclusively on the representations of DM and DR without question.¹⁶⁵

On the one hand, Spencer Edwards claims to have known during its sales of Digi notes that Digi did not have signed leases.¹⁶⁶ Yet Spencer Edwards never identified a realistic means for Digi to generate revenue to pay the notes without leases. Indeed, the very documents Spencer Edwards relied upon for its due diligence investigation—the documents in Digi's Dropbox—suggested that leases were somehow “secured,” and the firm never investigated what, if anything, Digi had done to secure leases. Nowhere are the inconsistencies about the existence and availability of leases more obvious than in the materials from Digi that Spencer Edwards' representatives shared with potential customers.

The document titled “Digi Outdoor Media, Inc. – The Opportunity” dated August 2013 touted that Digi was

¹⁶⁴ See, e.g., Tr. 551 (testimony of Spencer Edwards' registered representative Bataille that Digi's ability to secure prime locations for leases was crucial to the success of the Digi offering).

¹⁶⁵ Tr. 84-85. Lavigne testified as follows:

Q: What, if anything, did you or anyone from Spencer Edwards do to confirm that Digi could actually get the leases that they provided to you, or any leases, signed?

A: I don't know we did anything specifically.

Q: Did you really just rely on [DM] saying that “I can get these leases done”?

A: Yeah. [DM] and [DR] really.

Tr. 84-85.

¹⁶⁶ Notwithstanding Spencer Edwards' main defense that it and its customers knew that Digi did not have signed leases, DM represented to Larkin in January or February of 2014 that Digi had signed leases in hand. Tr. 721, 741. Larkin thereafter exerted a significant amount of pressure on Digi to try to get copies of signed leases. Tr. 721-22, 748-53; CX-91; CX-92. Lavigne testified that, sometime around March 2014, he learned that Digi had signed some leases. Tr. 292. Spencer Edwards did not obtain copies of any leases until after it completed selling the notes in August 2014. RX-9, at 1. Lavigne testified that, during the offering, Digi never told him how many leases had been signed and for which properties. Tr. 329.

[i]nitiating the installation, operation and management of 83 premium indoor and outdoor digital signage sites that have been secured by lease agreements in this market.¹⁶⁷

Under “Opportunity Highlights,” the document included statements such as

All lease contracts have at least a 10-year lifespan with most contracts having a minimum of 20 years, and option to renew these lease agreements.

Steep barriers for competitive entry . . . all premier locations belong to Digi.¹⁶⁸

Spencer Edwards contends it knew that Digi had not secured any leases for signage sites. Yet, this document suggests otherwise, and neither Lavigne nor anyone else at Spencer Edwards investigated further.¹⁶⁹ Although Lavigne saw no actual signs or locations that were secured by a lease when he visited Washington, D.C., Spencer Edwards represented to FINRA in the firm’s August 14, 2014 response to a Rule 8210 request for information that Quoy and Lavigne “viewed multiple Digi secured lease sites” during their visit to Washington, D.C.¹⁷⁰

In September 2013, DM copied Lavigne on an internal Digi email in which DM stated that Digi was in the process of getting leases “re-signed” and updated.¹⁷¹ In testimony, Lavigne agreed that the term “re-signed” suggested that Digi previously had secured leases for signage sites that the company was trying to renew, but Lavigne did not attempt to clarify this issue with DM or ask him for an explanation.¹⁷²

The Q3 2013 PowerPoint presentation from Digi included statements about leases for billboard space. For example, it represented there were “[p]rotected leases in place and ready to be signed upon funding.”¹⁷³ Lavigne knew that Digi did not have leases protected in any way during the offering.¹⁷⁴ He was unable to recall whether he or anyone at Spencer Edwards asked

¹⁶⁷ CX-17, at 1.

¹⁶⁸ CX-17, at 1.

¹⁶⁹ Lavigne testified that he could not recall if and how he confirmed that 83 sites existed and had been “secured,” or what “secured” meant in this context. Tr. 161-63, 171-72. Lavigne also could not recall if he knew that Digi in fact had lease contracts (signed or unsigned) with 10- or 20-year life spans. Tr. 249. When asked whether he interpreted the words “secured by lease agreement” to mean an executed lease existed, Lavigne responded, “I guess you could.” Tr. 172. Quoy also testified that the representations in this document were exaggerated and inaccurate. CX-117, at 128-29.

¹⁷⁰ Tr. 243-44, 249-50; CX-90, at 3.

¹⁷¹ Tr. 485-86; RX-7.

¹⁷² Tr. 485-86.

¹⁷³ CX-27, at 2.

¹⁷⁴ Tr. 238.

Digi's principals to explain what they meant by "protected leases" before Spencer Edwards used the PowerPoint presentation to sell Digi notes.¹⁷⁵ The same presentation stated, "Prime locations for signage have been cherry-picked."¹⁷⁶ Lavigne could not recall if Spencer Edwards asked Digi principals to explain their use of the term "cherry-picked."¹⁷⁷ The presentation stated, "Over 70 sites committed and ready for digital sign program once funding is completed."¹⁷⁸ Lavigne testified, "I don't know that I asked [Digi] exactly what 'committed' was."¹⁷⁹ Lavigne did not know how the sites were "ready" for the digital sign program, and he did not question Digi principals on this point, even though he also knew that Digi had not secured permits for 70 signs.¹⁸⁰

Digi's Dropbox included two spreadsheets listing locations and showing information about signs at those locations.¹⁸¹ The lease locations on the spreadsheets did not match each other. One spreadsheet listed 25 potential locations and the other listed only 12; four locations were listed on both spreadsheets.¹⁸² Lavigne testified that Digi's inclusion of these documents in the Dropbox confused him because they belonged to a related entity, not Digi, but he had no recollection of trying to match the properties listed on the spreadsheets to property identified by Digi where it hoped to erect digital billboards.¹⁸³ Notwithstanding his confusion, Lavigne never asked Digi's principals why they included either document in the Dropbox.¹⁸⁴

¹⁷⁵ Tr. 238-39.

¹⁷⁶ CX-27, at 2.

¹⁷⁷ Tr. 239.

¹⁷⁸ CX-27, at 3.

¹⁷⁹ Tr. 242-43.

¹⁸⁰ Tr. 243. Adding to the uncertainty, the Dropbox also included a Q1 2013 PowerPoint slide deck titled "DigiOutdoor LLC." See CX-26. This document specified that "protected lease agreements" were in place in the Washington, D.C. market and that the company was "currently building out multiple lease locations with additional lease agreements drafted and waiting." CX-26, at 2-3.

¹⁸¹ See CX-23; CX-24.

¹⁸² CX-23; CX-24.

¹⁸³ Tr. 147-50. Lavigne testified as follows with respect to one spreadsheet:

Q: Did you ever do anything to determine if it was relevant?

A: I don't remember. I don't remember if we asked it – asked them a question about it or not.

Q: Did you ever ask anyone at Digi why it was in the Dropbox to begin with?

A: No, I don't recall.

Q: Did you wonder why it was in the Dropbox?

A: Again, I don't – I don't recall.

Tr. 163.

¹⁸⁴ Tr. 173-74.

Spencer Edwards did not explain why, if it understood that Digi had no leases in place, Lavigne and Quoy stated otherwise to registered representatives at the firm and potential investors. Quoy told a Spencer Edwards registered representative on March 6, 2014, that Digi had “74 sites under lease.”¹⁸⁵ Bataille’s notes from a Spencer Edwards internal meeting about the offering suggest that he was led to believe “protected leases in place” meant that Digi had “a lease signed” and “some kind of a contract.”¹⁸⁶ In a December 18, 2013 email to one potential investor who missed Spencer Edwards’ investor conferences, Lavigne stated:

[DM] . . . has been securing some new leases and renewing some of the leases he already had in place. He currently has over half of the original 83 leases renewed and he has also added several new leases [H]e has also been working on pre-installation of the signs and has completed that for approximately 30% of the locations.¹⁸⁷

Lavigne testified that, although he knew when he sent this email Digi had no signed leases, he meant that DM had “talked to the landlord of those leases. They hadn’t signed yet, but that, you know, he basically had the landlords, you know, committed to sign them at some point.”¹⁸⁸ Lavigne relied on DM’s representations at the investor conferences for this information.¹⁸⁹

Lavigne repeated similar inaccurate statements about the Digi offering in other emails to potential investors. In March 2014, he emailed a potential investor stating that Digi “is initiating the installation, operation, and management of 83 premium indoor and outdoor digital signage sites that have been secured by lease agreements,” yet he claims to have known that Digi had not secured locations for 83 signs at that point.¹⁹⁰ The financial models that Lavigne included in March 2014 emails to two prospective investors contained pages referencing a variety of Digi-related entities.¹⁹¹ Although Lavigne sent these financial documents to potential investors in the Digi note offering, he was unable to explain why he included financial information for other Digi entities.¹⁹² Ultimately, he concluded that he attached them in error, and that only three of the ten pages in the financial models were relevant.¹⁹³ In the body of one of the March emails, Lavigne stated, “[T]he [financial] model contains only the original 83 signs but as I mentioned the other

¹⁸⁵ CX-76, at 1. Quoy admitted that “under lease” “may not have been the right word to use.”

¹⁸⁶ Tr. 555; RX-1, at 1.

¹⁸⁷ CX-32, at 1.

¹⁸⁸ Tr. 283.

¹⁸⁹ Tr. 283-86. Lavigne stated that he understood from DM that Digi had been granted access to sites to undertake “pre-installation” electrical work before signed leases could be put in place. Tr. 286-87. He did nothing to confirm this representation. Tr. 287.

¹⁹⁰ Tr. 291-92; CX-33.

¹⁹¹ Tr. 345-51, 356; CX-34, at 25-34; CX-35, at 25-34.

¹⁹² Tr. 345-49.

¹⁹³ Tr. 350-51, 356; CX-34, at 32-34; CX-35, at 25-34.

day, they are up to a little over 100 locations now.”¹⁹⁴ Lavigne stated that he had heard about “100 signs” from Digi, but had nothing in writing to confirm that, and had not seen any leases.¹⁹⁵

No one from Spencer Edwards spoke with the counterparties to Digi’s purported leases.¹⁹⁶ Lavigne and Quoy did nothing to ensure the sites Digi showed them when they visited Washington, D.C. were even available for lease by Digi.¹⁹⁷ As the offering progressed, Lavigne and others at Spencer Edwards learned that leases existed.¹⁹⁸ Even then, the firm did little to confirm Digi’s representations. Lavigne testified that he asked Digi several times to provide copies of the signed leases to no avail, and Larkin had to exert significant pressure to obtain copies.¹⁹⁹ The firm never requested a list of properties for which Digi had executed leases.²⁰⁰ Notwithstanding Digi’s representations to Spencer Edwards, and Spencer Edwards’ representations to potential investors of 70, 80, or more signed leases, in the end, Spencer Edwards obtained only 18 signed leases from Digi.²⁰¹

Overall, Spencer Edwards did nothing to understand the claims in the due diligence materials in the Dropbox and the offering documents that various numbers of “secured” leases existed and which properties were allegedly secured. The many inconsistencies in Digi’s documents as to the existence of signed leases, the number of leases, and the meaning of the terms used to suggest that leases were secured or protected, were red flags of irregularities that Spencer Edwards should have investigated. “A [member firm’s] reasonable investigation responsibilities would obligate it to follow up on any red flags that it encounters during its inquiry as well as to investigate any substantial adverse information about the issuer.”²⁰² Instead, Spencer Edwards ignored inconsistencies and relied blindly on the representations of DM, DR, and SD about the viability of a crucial element of Digi’s potential business success.

¹⁹⁴ CX-35, at 1.

¹⁹⁵ Tr. 357.

¹⁹⁶ Tr. 126-29, 149-50, 155-56, 504; CX-117, at 57.

¹⁹⁷ Tr. 243-46, 253-54.

¹⁹⁸ Tr. 124, 721, 741.

¹⁹⁹ Tr. 124-25, 721-22, 748-53; CX-91; CX-92.

²⁰⁰ Tr. 124-25.

²⁰¹ CX-117, at 78.

²⁰² FINRA Regulatory Notice 10-22, at 6 (citing *Everest Sec., Inc. v. SEC*, 116 F.3d 1235, 1239 (8th Cir. 1997)). See also *Gomez*, 2018 FINRA Discip. LEXIS 10, at *37 (holding that obvious errors and inconsistencies in the issuer’s documents should raise numerous questions about the offering); *Dep’t of Enforcement v. Luo*, No. 2011026346206, 2017 FINRA Discip. LEXIS 4, at *30-31 (NAC Jan. 13, 2017) (holding that broker who ignored red flags of irregularities failed to satisfy the reasonable basis suitability test).

2. Spencer Edwards Did Not Identify the Contents of Addendum D to Digi's Note Purchase Agreement Before Recommending and Selling the Notes

The Digi note offering did not have a prospectus. The Digi Note Purchase Agreement was the main piece of sales material for the Digi notes. The Digi Note Purchase Agreement identified four addenda:

1. Addendum A – Terms of the Offering;
2. Addendum B – Risk Factors;
3. Addendum C – Form of Convertible Promissory Note; and
4. Addendum D – Digi Outdoor Media, Inc. 2013 Executive Summary (for the 2013 version) or Addendum D – Digi Outdoor Media, Inc. 2014 Executive Summary (for the 2014 version).²⁰³

The many copies of the Digi Note Purchase Agreement in Spencer Edwards' files consistently included documents marked "Addendum A – Terms of the Offering" and "Addendum B – Risk Factors." Spencer Edwards' files also contained a subordinated promissory note that, although not marked "Addendum C," appeared to be the convertible promissory note form.²⁰⁴ Spencer Edwards' files included documents marked "Addendum D – Digi Outdoor Media, Inc. 2013 Executive Summary," or "Addendum D – Digi Outdoor Media, Inc. 2014 Executive Summary," but these documents were blank except for a standard two-paragraph disclaimer regarding forward-looking statements.²⁰⁵

At the hearing, witnesses identified different documents as Addendum D – Executive Summary. Lavigne claimed to be unable to recall specifically what Digi identified as the Executive Summary and could not recall specifically asking Digi to identify the document, notwithstanding its conspicuous absence from documents otherwise marked "Addendum D" and left blank but for a disclaimer.²⁰⁶ At other points during Lavigne's testimony, he identified several documents as Addendum D, although none of the documents was labeled "Addendum

²⁰³ RX-12, at 28. Lavigne testified that Spencer Edwards used the 2014 version of the Digi Note Purchase Agreement after March 2014, when Digi increased the note offering from \$1 million to \$1.5 million, and the 2013 version for sales prior to that time. Tr. 322-23. This testimony notwithstanding, Spencer Edwards used the 2013 version of the Digi Note Purchase Agreement for a May 2014 sale. CX-51. Lavigne could not explain the discrepancy. Tr. 325-26.

²⁰⁴ See CX-28, at 28; CX-48, at 28; CX-49, at 1; CX-51, at 1; CX-52, at 1; CX-53, at; CX-54, at 1; CX-55, at 28; CX-56, at 1; CX-57, at 1; CX-59, at 1; CX-60, at 28.

²⁰⁵ The firm's records included signed Digi Note Purchase Agreements for the customers who bought Digi notes. These Note Purchase Agreements included a document marked "Addendum D – Digi Outdoor Media, Inc. 2013 Executive Summary," or "Addendum D – Digi Outdoor Media, Inc. 2014 Executive Summary," but all were blank, except for a two-paragraph standard disclaimer regarding forward-looking statements. See CX-48; CX-49—CX-53; CX-55—CX-60. Two signed Digi Note Purchase Agreements contained no Addendum D. See CX-50; CX-54.

²⁰⁶ Tr. 480. Indeed, Lavigne stated, "I don't remember if I thought about that specifically." Tr. 420-21.

D,” “Digi Outdoor Media, Inc. 2013 Executive Summary,” or “Digi Outdoor Media, Inc. 2014 Executive Summary.” For example, Lavigne identified a document titled “Digi Outdoor Media, Inc. Summary Terms of the Offering” as Addendum D, but also identified a different document titled “Digi Outdoor Media, Inc.” and labeled “Confidential – Not for Circulation – August, 2013” as the document he referred to as the executive summary.²⁰⁷ Conversely, Lavigne denied earlier in his testimony that the document titled “Digi Outdoor Media, Inc.” and labeled “Confidential – Not for Circulation – August, 2013” was the executive summary referenced in the Digi Note Purchase Agreement.²⁰⁸

Lavigne’s testimony on this issue shifted throughout the hearing. During another series of questions, Lavigne identified the document titled “Digi Outdoor Media, Inc.” and labeled “Confidential – Not for Circulation – August, 2013” as the executive summary, then immediately backed off his own testimony and stated, “I don’t know. I’m going to assume it was the same one, but I don’t know.”²⁰⁹ At another point during Lavigne’s testimony, he again identified the document titled “Digi Outdoor Media, Inc.” and labeled “Confidential – Not for Circulation – August, 2013” as the executive summary, and testified definitively that he was unaware of any other executive summary available to Spencer Edwards in March 2014.²¹⁰ When asked to review the Digi Note Purchase Agreements actually signed by Spencer Edwards’ customers, Lavigne testified that he could not recall if there even was an executive summary.²¹¹ Finally, Spencer Edwards’ attorney asked Lavigne to review an email that Quoy sent to Spencer Edwards’ registered representatives in September 2013, to which Quoy appended a Digi Note Purchase Agreement. During Lavigne’s testimony about that email, he identified the document titled “Digi Outdoor Media, Inc. Summary Terms of the Offering” as the executive summary or Addendum D.²¹²

The Digi note offering did not include a prospectus. The Digi Note Purchase Agreement was the essential item for potential investors to receive and review. Yet no one at Spencer Edwards asked for definitive identification of the executive summary or the contents of the attachments called “Addendum D – Digi Outdoor Media, Inc. 2013 Executive Summary,” or “Addendum D – Digi Outdoor Media, Inc. 2014 Executive Summary.” The absence of a

²⁰⁷ Tr. 422, 481; CX-28, at 23-27.

²⁰⁸ Tr. 114-15.

²⁰⁹ Tr. 293; CX-34, at 3. *See also* Tr. 203-04 (Lavigne’s testimony that he could not be sure, but identified the document titled “Digi Outdoor Media, Inc.” and labeled “Confidential – Not for Circulation – August, 2013” as “[l]ikely” the executive summary).

²¹⁰ Tr. 344; CX-34, at 3-4.

²¹¹ Tr. 324; CX-50, at 3.

²¹² Tr. 440; RX-12, at 54.

substantive executive summary in Addendum D was a red flag that should have prompted Spencer Edwards to investigate as part of its due diligence.²¹³

3. Spencer Edwards Conducted an Inadequate Investigation into the Backgrounds of Digi's Principals and Liens against Digi

Lavigne recalled that Quoy conducted a criminal background check for DM and SD, but he could not recall any specifics or identify documentation to support his claim.²¹⁴ “To demonstrate that it has performed a reasonable investigation[, however,] a [member firm] should retain records documenting both the process and results of its investigation.”²¹⁵ Spencer Edwards failed to document its efforts.²¹⁶ Larkin testified that, when he joined Spencer Edwards, he saw no evidence in Spencer Edwards’ due diligence file of background checks on DM or SD.²¹⁷ He also was unsure if Quoy looked for civil litigation and liens, and whether Quoy checked for litigation against Digi.²¹⁸

Investors in Digi’s predecessor companies sued DM and SD twice, once before the Digi note offering and once while the offering was ongoing. The parties settled both cases.²¹⁹ LexisNexis reports that a judgment lien was filed after one settlement and that DM and SD were the subject of several federal and state tax liens during the five years preceding Spencer Edwards’ involvement with the Digi note offering.²²⁰ In addition, LexisNexis reports that multiple UCC liens were filed against Digi and Digi’s parent company during the year preceding Spencer Edwards’ involvement with the Digi note offering.²²¹ Spencer Edwards’ files contain nothing to suggest that the firm investigated civil matters and liens involving Digi and its principals. After the Digi offering, DM and SD were indicted on criminal charges related to the Digi offering and charged civilly with securities fraud by the SEC.²²²

²¹³ See FINRA Regulatory Notice 10-22, at 6 (stating that red flags should alert a firm to the need to conduct further inquiry into the offering).

²¹⁴ Tr. 81-82.

²¹⁵ FINRA Regulatory Notice 10-22, at 7.

²¹⁶ Indeed, Lavigne admitted that he did not document his requests for signed leases or Digi’s responses. Tr. 125. He also did not maintain a written record of the specific information he considered for the due diligence on Digi or document when he completed due diligence. Tr. 54.

²¹⁷ Tr. 733-34.

²¹⁸ Tr. 269-71.

²¹⁹ Tr. 631-36, 666-68; CX-98; CX-99; CX-100; CX-101.

²²⁰ CX-20, at 15-22; CX-21, at 29-34.

²²¹ Tr. 640-42; CX-22, at 4-6.

²²² Tr. 341-42, 663-65.

Lavigne stated that Spencer Edwards eventually learned of civil litigation involving allegations of securities fraud against DM and SD.²²³ He admitted that, had he known about the litigation before the offering, it might have changed how he and the firm handled the offering.²²⁴ Yet when Lavigne was responsible for Spencer Edwards' due diligence, he did little to ensure that the firm discovered all of the information available. "For a recommendation involving the private placement of securities, a [member firm] should conduct reasonable diligence of the issuer and the individuals involved with it."²²⁵ The liens against Digi and securities litigation against its principals should have raised questions about the principals' ability to run the company successfully and the credibility of their representations. Lavigne's failure even to attempt to unearth this information resulted in Spencer Edwards having an incomplete picture of Digi and an inadequate understanding of the potential risks associated with the note offering.²²⁶

4. Spencer Edwards Ignored Other Inconsistencies, Inaccuracies, and Gaps in the Information Provided by Digi

Spencer Edwards also ignored other inconsistencies, gaps, and inaccuracies in the information that Digi provided the firm in the Dropbox. For example, the Q3 2013 PowerPoint presentation stated that Digi was in the process of organizing a public offering, which would be launching within 60 to 90 days.²²⁷ Lavigne knew this was not accurate,²²⁸ but he did not question the Digi principals about the representation or halt Spencer Edwards' use of the PowerPoint. The Digi Note Purchase Agreement also included a representation from the issuer that Digi was in good standing under Nevada state laws.²²⁹ As of September 2013, this statement was untrue, and Lavigne knew that.²³⁰ Digi also provided Lavigne with financial projections that he believed to be overly optimistic.²³¹ In fact, Lavigne found them so unreliable that he asked his brother DL, a microcap analyst, to redo Digi's financials to "basically discount their projections."²³²

²²³ Tr. 271.

²²⁴ Tr. 271-72.

²²⁵ *Gomez*, 2018 FINRA Discip. LEXIS 10, at *34.

²²⁶ Registered representative Bataille testified that he conducted his own internet search of DM on Google. Tr. 788. He stated, "I didn't do a 20-page review on him. But I did two or three pages, and there was virtually nothing there." Tr. 788-89. Bataille's cursory search for DM's name on Google does not satisfy the due diligence investigation that Spencer Edwards should have undertaken.

²²⁷ CX-27, at 3.

²²⁸ Tr. 241-42.

²²⁹ Tr. 188-89; CX-18, at 5.

²³⁰ Tr. 189.

²³¹ Tr. 86-87, 245.

²³² Tr. 87-88. Lavigne's brother used the same projected sign sites, but different assumptions in the preparation of a financial model. Tr. 245-46.

Additionally, Spencer Edwards ignored questions raised by its own outside counsel, and never stopped selling the notes because of his concerns. On October 20, 2013, Quoy forwarded to Digi a list of questions from JS about the Digi offering.²³³ Among other inquiries, JS asked about the permitted uses of the offering proceeds and whether Digi will engage in a general solicitation in connection with the offering.²³⁴ Lavigne stated that he was not sure if Spencer Edwards ever received answers to these questions.²³⁵ On October 30, 2013, JS emailed Quoy and Lavigne stating that Digi was not a corporation in good standing in Nevada, its state of incorporation.²³⁶ Lavigne stated that he asked Digi to address the issue many times.²³⁷ Spencer Edwards did not receive a certificate of good standing signed by the Nevada Secretary of State until on or around May 12, 2014.²³⁸

On November 1, 2013, Quoy forwarded to Digi an email from JS. Attached to JS's email was a due diligence checklist on which JS had circled numerous items missing from the firm's due diligence file and needed from Digi.²³⁹ Among the information identified as missing were lists of leased property, contracts with entities engaged to manufacture and install signs, and a "schedule of all agreements relating to the sale or lease of material capital equipment or for advertising."²⁴⁰ Lavigne recalled receiving some of the information JS requested, but did not know if Spencer Edwards received all of it and stated some information was inconsistent.²⁴¹ On November 13, 2013, JS advised Quoy and Lavigne that Digi had not filed the necessary Form D

²³³ Tr. 256-57; CX-36.

²³⁴ CX-36, at 2.

²³⁵ Tr. 259. Lavigne testified that he was unclear how Digi would use the offering proceeds, and he did nothing to attempt to obtain this information. Tr. 339. Sample leases from Digi stated that Digi would pay rent based on the revenue it generated in the advertising space. Tr. 136-39, 143-44. Thus, money raised in the Digi note offering did not have to be used to pay rent. However, Lavigne had no idea if Digi intended to use the funds raised in the offering to install signs or to place lease deposits. Tr. 136-39. "For a recommendation involving the private placement of securities, a [member firm] should conduct reasonable diligence of the . . . handling and use of the offering's proceeds." *Gomez*, 2018 FINRA Discip. LEXIS 10, at *34. In this, Lavigne failed.

²³⁶ Tr. 190-91; CX-37.

²³⁷ Tr. 191.

²³⁸ Tr. 191-92; CX-40.

²³⁹ CX-38, at 2. Specifically, JS stated:

Attached is the due diligence form on which I have circled the most important items we need from Digi after reviewing the information in their dropbox. If anything is in the drop box ask them to please indicate where it is. The problem I had with the drop box was that the information was from different time periods and some of it was inconsistent.

CX-38, at 2.

²⁴⁰ CX-38, at 3, 6.

²⁴¹ Tr. 263-69. *See* FINRA Regulatory Notice 10-22, at 6 ("An issuer's refusal to provide a broker-dealer with information that is necessary for the broker-dealer to meet its duty to investigate could itself constitute a red flag.").

Notice of Exempt Offering of Securities (“Form D”) with the SEC.²⁴² Lavigne testified that he encouraged Digi to file a Form D early in the offering period.²⁴³ Larkin testified that he too “raised a stink” about Digi’s failure to file the Form D.²⁴⁴ SD eventually signed the Form D, which Digi filed August 8, 2014, near the end of the offering.²⁴⁵

The Dropbox included a resume for DM.²⁴⁶ Lavigne did not investigate representations in the resume that appeared to contradict other information provided by Digi. For example, the resume claimed that Digi Outdoor, LLC (Digi’s parent company) “[had] identified and leased 40 plus digital advertising opportunities in the very lucrative Washington DC Metro Area.”²⁴⁷ Spencer Edwards’ claims to have known that Digi had not executed leases for billboard space, yet Lavigne never questioned this representation.²⁴⁸ DM’s resume also indicated that he served as general manager and principal of Fourpoints Communications, LLC from 2004 through 2010.²⁴⁹ Before Spencer Edwards began selling the Digi offering, Fourpoints Communications’ investors filed a civil lawsuit against DM alleging securities fraud, but Spencer Edwards was unaware of the litigation during its sale of Digi notes.²⁵⁰ Similarly, DM’s resume noted his service as general manager and principal of Wall to Wall Advertising, LLC from 1998 through 2006.²⁵¹ In May 2014, while Spencer Edwards was selling Digi notes, investors in Wall to Wall Advertising filed a civil lawsuit against DM alleging securities fraud.²⁵² Once again, Spencer Edwards did not discover the litigation as part of its due diligence investigation.²⁵³

Accordingly, we find that Spencer Edwards recommended Digi notes without having a reasonable basis for the recommendations, in violation of FINRA Rules 2111(a) and 2010. Spencer Edwards recommended the Digi notes to customers without independently verifying representations from the issuer’s principals. Instead, led by Lavigne, the firm relied blindly on

²⁴² Tr. 193-94; CX-39, at 1.

²⁴³ Tr. 194-95.

²⁴⁴ Tr. 733.

²⁴⁵ Tr. 196; CX-41, at 6. And when Digi finally filed the Form D, it was not accurate. In an earlier email, Quoy advised JS that the Digi offering commenced on October 18, 2013. CX-39, at 1. Digi’s Form D eventually filed with the SEC reported that the first sale in the note offering was October 28, 2013. CX-41, at 4. In reality, Spencer Edwards began selling Digi notes in September 2013. Tr. 195-96.

²⁴⁶ Tr. 222-23.

²⁴⁷ Tr. 224; CX-25, at 1.

²⁴⁸ Tr. 224.

²⁴⁹ CX-25, at 1.

²⁵⁰ Tr. 225; CX-98.

²⁵¹ CX-25, at 1.

²⁵² CX-100.

²⁵³ Tr. 226.

DM, SD, and DR, and took their representations at face value.²⁵⁴ The firm ignored red flags suggesting that statements about leases in materials provided by the issuer were false. With respect to leases, a crucial aspect of Digi's business plan, the firm never questioned what the terms "secured," "committed," and "protected" meant. Spencer Edwards did not investigate the principals' backgrounds or delve into Digi's financial situation.

The firm did not notice or seem to care that a document was missing from the Digi Note Purchase Agreement and that their outside counsel flagged other missing and conflicting information. The firm was not troubled by Digi's failure to maintain good standing in the state of its incorporation or its failure to file a Form D with the SEC. When Lavigne learned in March 2014 that some leases supposedly existed,²⁵⁵ the firm continued to sell Digi notes even though the issuer avoided the firm's requests for copies of the leases. Spencer Edwards also never fully understood Digi's planned use of offering proceeds and the viability of Digi's plan to generate revenue sufficient to pay the notes. FINRA's suitability rule "requires that a broker have a reasonable basis to believe [its] recommendation could be suitable for at least some customers by his understanding the potential risks and rewards inherent in that recommendation."²⁵⁶ Spencer Edwards failed to meet this standard.

B. Cause Two – False, Misleading, and Unbalanced Communications with Customers

Cause two of the Complaint alleges that Spencer Edwards, through Lavigne and Quoy, distributed to potential investors materially misleading documents that failed to present a balanced statement of the benefits and risks of the Digi notes, in violation of FINRA Rules 2210 and 2010. Specifically, cause two alleges that the firm distributed an opportunity summary (identified previously in this decision as a two-page information sheet titled "Digi Outdoor Media, Inc." and marked "Confidential – Not for Circulation – August, 2013") that contained false or misleading statements about the existence or status of leases or lease commitments for digital signage. Cause two alleges that the opportunity summary stated that Digi was initiating the installation and operation of 83 premium indoor and outdoor digital signs secured by lease agreements, when in fact none of the signage sites was secured by lease agreements when the firm distributed the document. Cause two also alleges that the opportunity summary discussed lease terms in a misleading manner because the issuer had no lease commitments of any duration when the firm distributed the document.

²⁵⁴ See *Gomez*, 2018 FINRA Discip. LEXIS 10, at *36-37 (holding that respondent could not "blindly rely" on information provided by individuals associated with the issuer); cf. *Dep't of Enforcement v. Friedberg*, No. 2010024522103, 2016 FINRA Discip. LEXIS 6, at *31 (OHO Mar. 23, 2016) (holding that respondent could not rely solely on statements made by superiors at member firm and in offering documents).

²⁵⁵ See Tr. 292.

²⁵⁶ *Dep't of Enforcement v. Brookstone Sec., Inc.*, No. 2007011413501, 2015 FINRA Discip. LEXIS 3, at *46 n.24 (NAC Apr. 16, 2015).

Cause two further alleges that the firm distributed a PowerPoint document (identified previously in this decision as “Q3 2013 PowerPoint presentation”) that contained false or misleading statements in that it stated that more than 70 sites were committed and ready for digital sign installation once funding was complete. It also alleges that the PowerPoint presentation falsely stated that protected leases were in place and ready to be signed upon funding. Cause two also alleges that the opportunity summary and PowerPoint presentation lacked any discussion of the risks associated with an investment in Digi notes. Cause two alleges that the Digi Note Purchase Agreement contained risk disclosures, but failed to discuss the risks related to DM’s prior securities fraud litigation, civil judgements, and liens, any of which could have impacted Digi’s assets and business.

FINRA Rule 2210(d)(1)(A) requires that all communications with the public be fair and balanced and provide a sound basis for evaluating the facts regarding any security, industry, or service. The Rule further states that a communication may not omit any material fact or qualification if the omission, in light of the content of material presented, would cause the communication to be misleading.²⁵⁷ FINRA Rule 2210(d)(1)(B) prohibits a member firm from distributing any communication that it has reason to know contains any statement that is false or misleading. FINRA Rule 2210(d)(1)(D) requires member firms to ensure that statements in communications with the public are clear and not misleading within the context in which they are made, and provide balanced treatment of risks and potential benefits.

The content standards for communications with the public require member firms to

base their public communications on principles of fair dealing and good faith, ensure that their communications are fair and balanced, provide within their communications a sound basis for evaluating the facts in regard to any particular security . . . and to disclose any material fact if the omission of that fact, in light of the material presented, would cause the communications to be misleading.²⁵⁸

²⁵⁷ The test of whether a misstated or omitted fact is material is whether a reasonable investor would consider the information significant. *See Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). In other words, a misstated or omitted fact is material if a reasonable investor would have viewed the fact as having altered the “total mix” of information made available. *See TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). The “reasonable investor” standard is an objective one. *Id.* at 445. A reasonable investor, for instance, would certainly consider significant information pertaining to an issuer’s financial condition and potential profitability. *See William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *72 (July 2, 2013) (holding that a reasonable investor would find information concerning profits, losses, and value material); *Charles E. French*, 52 S.E.C. 858, 863 n.19 (1996) (holding that one cannot successfully challenge the materiality of information related to the financial condition, solvency, and profitability of the issuer).

²⁵⁸ *Brookstone Sec.*, 2015 FINRA Discip. LEXIS 3, at *88.

Sales literature that fails to present a balanced statement of an investment's benefits and risks is misleading.²⁵⁹

Spencer Edwards distributed the Q3 2013 PowerPoint, the "Digi Outdoor Media, Inc." document marked "Confidential – Not for Circulation – August, 2013," and the Digi Note Purchase Agreement by email.²⁶⁰ The firm also sponsored two December 2013 investor conferences during which potential investors received these and other documents.²⁶¹

1. The Document Titled "Digi Outdoor Media, Inc." and marked "Confidential – Not for Circulation – August, 2013" Was Misleading and Unbalanced and Contained No Risk Disclosure

The "Digi Outdoor Media, Inc." document marked "Confidential – Not for Circulation – August, 2013," stated that Digi "is initiating the installation, operation, and management of 83 premium indoor and outdoor digital signage sites that have been secured by lease agreements in this market."²⁶² It also stated, "All lease contracts have at least a 10-year lifespan with most contracts having a minimum of 20 years, and option to renew these lease agreements," and "all premiere locations belong to Digi."²⁶³

These statements indicate or insinuate that Digi had leases in place. Ultimately, even Lavigne had to concede that this document reasonably could be read to indicate that Digi had signed and executed leases for 83 billboard sites.²⁶⁴ Lavigne and Quoy, however, testified repeatedly that, in August 2013, Digi had no executed leases for the installation of digital signs.²⁶⁵ Lavigne also testified that he had no knowledge of Digi having secured rights to begin preparatory work for sign installation before Digi executed leases.²⁶⁶ We find that the statements on the "Digi Outdoor Media, Inc." document marked "Confidential – Not for Circulation –

²⁵⁹ See *Capwest Sec., Inc.*, Exchange Act Release No. 71340, 2014 SEC LEXIS 205, at *17-18 (Jan. 17, 2014) (holding that communications that promote positive features in an unfair and unbalanced way are misleading); *Dep't of Enforcement v. Rogala*, No. C8A030089, 2005 NASD Discip. LEXIS 44, at *19 (NAC Oct. 11, 2005) ("As the Commission has held, sales literature that fails to present a balanced statement of an investment's benefits and risks is misleading.").

²⁶⁰ Tr. 104-15, 118-20, 237, 247, 277-88, 290-96, 343-51; CX-17; CX-28; CX-29; CX-30; CX-32; CX-33; CX-34; CX-35.

²⁶¹ Tr. 274-77.

²⁶² CX-17, at 1.

²⁶³ CX-17, at 1.

²⁶⁴ Tr. 250.

²⁶⁵ Tr. 84-85, 122-25, 129, 153-54, 170, 238, 250, 276-77, 284, 292, 349, 404, 427, 463, 486; CX-117, at 65, 74, 76.

²⁶⁶ Tr. 129, 135-36, 140-42.

August, 2013,” were misleading and unbalanced.²⁶⁷ The document also does not include a risk disclosure of any kind to balance its positive representations.

Spencer Edwards argues that, regardless of what was included in the written materials, its registered representatives advised every potential investor that Digi had not secured signed leases. But Lavigne could not confirm that the firm advised every potential investor who received the “Digi Outdoor Media” August 2013 document that Digi in fact had no signed leases.²⁶⁸ Indeed, Lavigne could not identify with certainty which customers received the document, notwithstanding his claim that he thought Quoy maintained a list of customers who received it.²⁶⁹ Quoy could not recall that Spencer Edwards tracked the dissemination of documents to potential investors in the Digi offering, and the evidence does not include any sort of tracking document.²⁷⁰

2. The Document Titled “Q3 2013 PowerPoint” Was Misleading and Unbalanced and Contained No Risk Disclosure

Spencer Edwards used the second PowerPoint provided by Digi, dated “Q3 2013,” as part of its sales materials.²⁷¹ The Q3 2013 PowerPoint stated that there were “[p]rotected leases in place and ready to be signed upon funding” and “[o]ver 70 sites committed and ready for digital sign program once funding is completed.”²⁷² Lavigne testified, “I don’t know that I asked [Digi] exactly what ‘committed’ was.”²⁷³ Lavigne also did not know how the sites were “ready” for the digital sign program, and he did not question Digi principals on this point.²⁷⁴ We find that the Q3 2013 PowerPoint did not explain what it meant for signage sites to be “committed and ready for digital sign program.” Nor did it disclose the possible risks associated with the recommended investment. We find that the Q3 2013 PowerPoint presentation was misleading and unbalanced

²⁶⁷ We find that these misrepresentations were material. Digi’s only avenue for generating revenue was the installation of digital billboards at prime locations in the Washington, D.C. metropolitan area. Thus, its ability to secure lease agreements for signage sites was pivotal to its business plan and ability to make a profit. The misrepresentations in the “Digi Outdoor Media, Inc.” document marked “Confidential – Not for Circulation – August, 2013,” were therefore material. *See Donner Corp. Int’l*, No. CAF020048, 2006 NASD Discip. LEXIS 4, at *35 (NAC Mar. 9, 2006) (finding that information related to the issuer’s business prospects and finances are part of the basic foundation upon which a reasonable investor relies).

²⁶⁸ Tr. 250-51.

²⁶⁹ Tr. 250-51.

²⁷⁰ CX-118, at 38-39.

²⁷¹ Tr. 236-37; CX-27.

²⁷² CX-27, at 2-3.

²⁷³ Tr. 242-43.

²⁷⁴ Tr. 129, 135-36, 242-43.

in that it implied that signed leases existed or were otherwise secured when, in fact, they were not.²⁷⁵

3. The Note Purchase Agreement Contained Inadequate Risk Disclosures Because They Did Not Disclose Litigation, Judgments, and Liens

The Digi Note Purchase Agreement contains a lengthy section titled “Risk Factors.”²⁷⁶ Absent from the risk factors listed in this section, however, are disclosures that DM and SD had twice been sued civilly for securities fraud and had settled the lawsuits.²⁷⁷ It also failed to mention judgment and tax liens against DM and SD and UCC liens against Digi and Digi’s parent company.²⁷⁸ DM and SD were two of three principals responsible for Digi’s operations and, at the time of Spencer Edwards’ sales of Digi notes, they owned and controlled Digi Outdoor, LLC, Digi’s parent company.²⁷⁹ Digi required substantial working capital to fund its digital billboard business. Thus, hiding from investor scrutiny legal judgments against principals of the issuer is a material omission that caused the Digi Note Purchase Agreement to be misleading. Furthermore, the liens and judgments could have affected Digi’s financial well-being and their omission was material.

“When a securities recommendation is made to a customer, it is necessary that full disclosure be made of all material facts. A broker may not satisfy that obligation by pointing to bits and pieces of information.”²⁸⁰ The Digi Note Purchase Agreement, Q3 2013 PowerPoint, and “Digi Outdoor Media, Inc.” document marked “Confidential – Not for Circulation – August, 2013” contained false, misleading, and unbalanced representations of material facts. Accordingly, we find that Spencer Edwards violated FINRA Rules 2210 and 2010, as alleged in cause two.²⁸¹

²⁷⁵ We find that these misrepresentations were material. Digi depended on its ability to secure leases for signage sites to generate revenue that would enable it to pay on the Digi notes. A reasonable investor therefore would find material a misrepresentation about the issuer’s ability to secure leases.

²⁷⁶ CX-18, at 20-25.

²⁷⁷ Tr. 631-36, 666-68; CX-98; CX-99; CX-100; CX-101.

²⁷⁸ Tr. 640-42; CX-20, at 15-22; CX-21, at 29-34; CX-22, at 4-6.

²⁷⁹ Tr. 215-16.

²⁸⁰ *Richmark Capital Corp.*, Exchange Act Release No. 48758, 2003 SEC LEXIS 2680, at *24 (Nov. 7, 2003), *aff’d*, 86 F. App’x 744 (5th Cir. 2004); *see also Donner Corp. Int’l*, 2006 NASD Discip. LEXIS 4, at *84.

²⁸¹ *See Murphy*, 2013 SEC LEXIS 1933, at *71-73 (finding violations where communications were “filled with errors” concerning profits and failed to identify substantial risks associated with the recommended strategy); *Rogala*, 2005 NASD Discip. LEXIS 44, at *18-19 (finding violations where communications failed to identify the product offered and provided no sound basis for evaluating the investment recommended).

C. Cause Three – Inadequate Supervision and WSPs

Cause three of the Complaint alleges that Spencer Edwards violated NASD Rule 3010(a) and (b) and FINRA Rule 2010 by inadequately supervising due diligence and responding to red flags in the Digi note offering. Cause three also alleges that the firm failed to maintain a documented record of the due diligence the firm actually conducted and when due diligence was completed. In addition, cause three alleges that the firm’s WSPs for due diligence were overly general and provided inadequate guidance.

The version of NASD Rule 3010(a) in effect during the period relevant to the Complaint required each member firm to establish and maintain a system to supervise the activities of all persons associated with the firm reasonably designed to achieve compliance with all applicable securities laws and regulations and FINRA rules. The version of NASD Rule 3010(b) in effect during the same period required each member firm to establish, maintain, and enforce written supervisory procedures designed to supervise the type of businesses in which the firm engages.

1. Spencer Edwards Maintained Inadequate WSPs Regarding Due Diligence for Private Placements

“Broadly speaking, WSPs are a written set of policies and procedures that describe concrete steps to supervise a firm’s activities.”²⁸² A firm’s WSPs must identify who is responsible for taking those steps and establish a system to document the steps taken so that the firm can ensure proper implementation.²⁸³

Spencer Edwards’ WSPs for due diligence review of private placements and other securities offerings missed the mark in numerous ways. The WSPs dated August 2013 required the firm to undertake an adequate due diligence review of all offerings and offering documents, but provided minimal detail and guidance.²⁸⁴ The WSPs stated that, for each offering, Spencer Edwards must meet “a set of minimum standards” in order to participate.²⁸⁵ The WSPs did not specifically define the minimum standards necessary to participate in an offering. Instead, they provided a list of items that may or may not be included in the due diligence file, but did not specify any specific steps that must be followed or indicate which of the listed items must be reviewed and which were optional.²⁸⁶

²⁸² *Dep’t of Enforcement v. Scottsdale Capital Advisors Corp.*, No. 2014041724601, 2017 FINRA Discip. LEXIS 26, at *197 (OHO June 20, 2017), *aff’d*, 2018 FINRA Discip. LEXIS 16 (NAC July 20, 2018), *appeal docketed*, No. 3-18612 (SEC July 23, 2018).

²⁸³ *Id.* See also *Dep’t of Enforcement v. Ranni*, No. 20080117243, 2012 FINRA Discip. LEXIS 6, at *15 (OHO Mar. 9, 2012) (holding that WSPs are a “written set of policies and procedures that every [member firm] is required to create, maintain, update, and adhere to”).

²⁸⁴ Tr. 588; CX-78, at 12.

²⁸⁵ CX-78, at 12.

²⁸⁶ CX-78, at 12.

The WSPs also failed to properly identify the individuals actually responsible for due diligence and supervision of due diligence. The August 2013 WSPs stated that due diligence review was the responsibility of firm owner and chief executive officer Dihle or the chief compliance officer.²⁸⁷ This contrasted sharply with Lavigne's and Flemming's testimony that Flemming supervised Lavigne, and Lavigne was responsible for due diligence. Flemming acknowledged that the WSPs did not identify Lavigne until a much later date.²⁸⁸ Her explanation for the inaccuracy was that "sometimes when [she] revised these, [she] didn't change the revision date at the bottom."²⁸⁹ Flemming testified that she replaced Dihle as president and chief compliance officer around the time of the Digi offering and never consulted with Dihle about Digi.²⁹⁰ Yet the August 2013 WSPs stated that Dihle or the chief compliance officer would maintain due diligence files.²⁹¹

The Due Diligence section of Spencer Edwards' WSPs did not change until production of the November 2013 WSPs.²⁹² This version stated that the firm's due diligence review was the responsibility of outside counsel or the chief compliance officer.²⁹³ This version did not mention Lavigne, although it should have.²⁹⁴ Spencer Edwards never revised the WSPs' Due Diligence section so that they accurately included Lavigne. As of the August 2014 WSPs, the Due Diligence section stated, "Due Diligence review shall be the responsibility of outside counsel and/or the [chief compliance officer]," and still did not mention Lavigne.²⁹⁵

Notwithstanding the WSPs' requirement that outside counsel or the chief compliance officer maintain files reflecting the firm's due diligence, Lavigne testified that he did not recall any procedures at Spencer Edwards that required him to document when he had completed due

²⁸⁷ CX-78, at 12.

²⁸⁸ Tr. 588-89.

²⁸⁹ Tr. 589.

²⁹⁰ Tr. 577.

²⁹¹ CX-78, at 12.

²⁹² Tr. 592-93.

²⁹³ CX-80, at 12.

²⁹⁴ Tr. 593.

²⁹⁵ CX-81, at 12; CX-82, at 12; CX-83, at 12; CX-84, at 12; CX-85, at 12; CX-86, at 12; CX-87, at 12; CX-88, at 12. Flemming testified, "I don't know how that happened, because I thought that it had been changed." Tr. 596. Flemming also testified that, in November 2013, Spencer Edwards' outside counsel, JS, a person not registered or associated with the firm, was in fact supervising Lavigne's due diligence. Tr. 595. Flemming further testified:

Q: And if [outside counsel] had advised in a negative fashion about something, what action was taken by you as the [chief compliance officer]?

A: I left it up to the investment banking department.

Tr. 595.

diligence on any particular deal.²⁹⁶ Quoy, the individual who assisted Lavigne with the firm's due diligence, did not even know if Spencer Edwards' due diligence procedures were in writing.²⁹⁷ Quoy testified that the investment banking department conducted all due diligence for the firm, then passed the file on to Flemming, not JS, for approval.²⁹⁸

In FINRA Regulatory Notice 10-22, FINRA reminded member firms of their obligation in Regulation D offerings to have supervisory procedures reasonably designed to ensure that the firm engages in an inquiry sufficiently rigorous to comply with suitability requirements and that it properly supervises the inquiry.²⁹⁹ We find that Spencer Edwards' WSPs regarding the requirements for due diligence of the Digi note offering were insufficient, in violation of NASD Rule 3010(b) and FINRA Rule 2010.

2. Spencer Edwards Inadequately Supervised Due Diligence on the Digi Offering and Failed to Respond to Red Flags

Member firms are required to maintain adequate supervisory systems and procedures. But “the presence of procedures alone is not enough. Without sufficient implementation, guidelines and strictures do not ensure compliance.”³⁰⁰ In addition to requiring adequate supervisory systems and procedures, “the duty of supervision includes the responsibility to investigate ‘red flags’ that suggest that misconduct may be occurring and to act upon the results of such investigation.”³⁰¹ We find Spencer Edwards' supervisory procedures and responses to red flags signaling irregularities woefully deficient with respect to due diligence.

Flemming testified that Lavigne was “in charge of investment banking,” and she was his supervisor.³⁰² When asked how she specifically supervised his investment banking activities, however, she responded that she “really didn't” do anything and primarily relied on outside counsel, who was not associated with Spencer Edwards, to supervise Lavigne.³⁰³

²⁹⁶ Tr. 51-52.

²⁹⁷ CX-117, at 31.

²⁹⁸ CX-117, at 68.

²⁹⁹ FINRA Regulatory Notice 10-22, at 7.

³⁰⁰ *Dep't of Enforcement v. North*, No. 2012030527503, 2017 FINRA Discip. LEXIS 28, at *11 (NAC Aug. 3, 2017), *appeal docketed*, No. 3-18150 (SEC Sept. 7, 2017).

³⁰¹ *Brookstone Sec.*, 2015 FINRA Discip. LEXIS 3, at *98; *see also Dep't of Enforcement v. KCD Fin., Inc.*, No. 2011025851501, 2016 FINRA Discip. LEXIS 38, at *70-71 (NAC Aug. 3, 2016) (holding that assuring proper supervision of every aspect of a firm's operations is a “critical component” of broker-dealer operations).

³⁰² Tr. 571.

³⁰³ Tr. 572 (“Q: What, if anything, did you do to supervise what [Lavigne] was doing? A: I really didn't. I didn't claim any knowledge. We had outside counsel, too.”); Tr. 572-73 (“Q: And you mentioned kind of [outside counsel's] role. Do you know that he was specifically involved in the supervision of due diligence? A: I wouldn't say ‘supervision.’ I would say ‘advice.’”).

Flemming testified as follows specifically with respect to her supervision of Lavigne's due diligence activities:

Q: So Mr. Lavigne was responsible for making sure the due diligence was properly done?

A: Yes.

Q: And did you do anything to check and make sure that he was doing what he should have been doing?

A: Well, no, because as I said, I didn't have the knowledge to do that.³⁰⁴

As further evidence of Spencer Edwards' lack of supervisory procedures related to due diligence, Flemming testified as follows:

Q: If Mr. Lavigne's due diligence on Digi was inadequate, who at Spencer Edwards should have caught that?

A: Well, I think there was nobody beyond [Lavigne] who could have because, like I said, I hired him to do a job I was not able to do.

Q: So do you agree that you were not equipped to determine whether Mr. Lavigne's due diligence was adequate or not?

A: Yes, I would have to agree with that.³⁰⁵

Flemming's admission that neither she, Lavigne's self-identified supervisor, nor anyone else at Spencer Edwards was capable of supervising Lavigne's due diligence work is compelling evidence of the firm's inadequate supervisory procedures.³⁰⁶

Flemming distanced herself from the Digi note offering. She testified that she did little to investigate the offering before signing the investment banking agreement that enabled the firm to participate in the offering.³⁰⁷ Flemming stated that, when she signed the investment banking agreement, her understanding of the firm's due diligence investigation was that "[Lavigne] was handling it."³⁰⁸ Indeed, Spencer Edwards' investment banking agreement is the only Digi-related document that Flemming even reviewed.³⁰⁹ Flemming did not see Digi marketing materials,

³⁰⁴ Tr. 573-74.

³⁰⁵ Tr. 579.

³⁰⁶ Cf. *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *35 (June 29, 2007) (stating that a member firm's supervisory policies and procedures must ensure that supervisors understand and can effectively conduct their supervisory duties).

³⁰⁷ Tr. 574.

³⁰⁸ Tr. 578.

³⁰⁹ Tr. 580.

meet Digi’s officers, or attend Spencer Edwards’ internal meetings related to Digi.³¹⁰ Flemming believed that Lavigne’s due diligence file for Spencer Edwards should have included Digi financial statements and its business plan, but she never checked to ensure that it did.³¹¹ Flemming testified that she maintained a due diligence file for the Digi offering. She testified that Lavigne “just gave me copies of what he had and I put them in my file.”³¹² She admitted that she did not, however, review or maintain a record of what Lavigne gave her and could not answer whether the due diligence file for Digi included financial statements and a business plan.³¹³

Spencer Edwards left it to Lavigne essentially to supervise his own due diligence work. Lavigne had no experience leading an investment banking department and had only recently joined the firm. Yet Spencer Edwards had no one in place and equipped to supervise Lavigne’s due diligence activities. As we detail in subsection IV.A.4 of this decision, inconsistencies littered the firm’s due diligence materials, and the firm should have treated these inconsistencies as red flags. Instead, the firm ignored red flags and did virtually nothing to supervise due diligence on the Digi offering. Accordingly, we find that Spencer Edwards violated NASD Rule 3010(a) and (b) and FINRA Rule 2010, as alleged in cause three of the Complaint.

D. Causes Four, Five, and Six – Holding a Customer Check and Willfully Violating Exchange Act Rules

Cause four alleges that Spencer Edwards failed to forward promptly a customer check to Digi, in willful violation of Exchange Act Rule 15c2-4(a) and FINRA Rule 2010. Cause five alleges that, as a result of holding the customer check, Spencer Edwards failed to maintain the required minimum net capital for the months of September and October 2013, in willful violation of Exchange Act Rule 15c3-1 and FINRA Rule 2010. Cause six alleges that Spencer Edwards failed to conduct a daily reserve calculation and set aside a special reserve account for the protection of customers, which it was required to do because it held the customer check, in willful violation of Exchange Act Rule 15c3-3 and FINRA Rule 2010.

1. Exchange Act Rule 15c2-4

Exchange Act Rule 15c2-4 requires member firms engaged in a best-efforts offering such as the Digi note offering to promptly transmit checks received as payment to the issuer or other person entitled to the funds. The requirement to “promptly transmit” funds to the issuer is

³¹⁰ Tr. 579-81.

³¹¹ Tr. 591.

³¹² Tr. 590.

³¹³ Tr. 590-91.

deemed to be fulfilled if the firm transmits the customer funds by noon on the business day following receipt.³¹⁴

Bataille's customers G & BT signed the Digi Note Purchase Agreement on September 24, 2013, and submitted it to Spencer Edwards along with a check for \$50,000, dated September 24, 2013.³¹⁵ Bataille testified that Spencer Edwards' personnel advised him that the firm received G & BT's check, and he and Flemming saw the signed note purchase agreement that accompanied the check.³¹⁶ In light of these customers' ages, Spencer Edwards requested an updated new account form, which it received on October 1, 2013.³¹⁷ Between October 12 and 15, 2013, Lavigne responded to Digi's anxious inquiries about G & BT's check, but did not forward it to Digi until on or after October 18, 2013.³¹⁸

We find that Spencer Edwards failed to transmit promptly G & BT's check to Digi as required by Rule 15c2-4. The evidence demonstrates that the firm received the check shortly after September 24, 2013, and did not transmit it until three or more weeks later because it was waiting for additional information from the customers. By holding the check rather than returning it to the customers while it waited for that additional information, however, Spencer Edwards violated Exchange Act Rule 15c2-4 and FINRA Rule 2010, as alleged in cause four of the Complaint.³¹⁹

³¹⁴ See Exchange Act Release No. 31511, 1992 SEC LEXIS 3163, at *24 n.11 (Nov. 24, 1992); *Dillon Sec., Inc.*, 51 S.E.C. 142, 148-49 (1992) (holding that Rule 15c2-4 is designed to insulate the proceeds raised in an offering from unlawful activities and financial reversals of broker-dealers by requiring that "such funds should normally be deposited or transmitted by noon of the business day following their receipt"). Subsequent to October 2013, FINRA provided limited relief regarding the requirement to transmit customer funds by noon the following day under certain circumstances not applicable here. See FINRA Regulatory Notice 15-23 (June 2015), <http://www.finra.org/industry/notices/15-23>.

³¹⁵ CX-48, at 11; CX-104, at 1 (G & BT's signed statement indicating they submitted the September 24, 2013 check to Spencer Edwards by mail soon after writing it).

³¹⁶ Tr. 537. Spencer Edwards argues that Enforcement failed to prove the exact date of the firm's receipt of the check. Because Spencer Edwards' recordkeeping was woefully deficient, the firm could not say with certainty when exactly it received the check. Flemming stated that "[t]he truth is [she has] no idea" what happened to G & BT's check or how long the firm held it, and she made no effort to investigate or ensure the firm properly handled the check. Tr. 609-11. Bataille's testimony, G & BT's joint written statement, and the dates contained on all of G & BT's Digi paperwork demonstrate to us that the firm indeed received G & BT's check soon after they mailed it on September 24, 2013.

³¹⁷ Tr. 609-10; CX-48, at 39-41.

³¹⁸ Tr. 306-14; CX-45; CX-46.

³¹⁹ See *William Scholander*, Exchange Act Release No. 77492, 2016 SEC LEXIS 1209, at *15 (Mar. 31, 2016) ("FINRA Rule 2010 requires members and their associated persons to observe 'high standards of commercial honor and just and equitable principles of trade,' and a violation of the Exchange Act or any FINRA rule constitutes a violation of Rule 2010.").

2. Exchange Act Rule 15c3-1

Exchange Act Rule 15c3-1 (commonly known as the Net Capital Rule) requires every broker-dealer to maintain at all times specified minimum levels of liquid assets or net capital. “The principal purposes of the net capital rule are to protect customers and other market participants from broker-dealer failures and to enable those firms that fall below the minimum net capital requirements to liquidate in an orderly fashion.”³²⁰ The Net Capital Rule requires broker-dealers to maintain minimum net capital that is the greater of a fixed dollar amount prescribed in the rule or an amount computed using the rule’s financial ratios.³²¹ The Net Capital Rule provides a minimum net capital requirement of \$100,000 for a broker-dealer like Spencer Edwards that operates pursuant to Exchange Act Rule 15c3-3(k)(2)(ii) because such firms carry no margin accounts, promptly transmit all customer funds, promptly deliver all securities received, and do not otherwise hold customer funds or securities. Thus, Spencer Edwards’ minimum net capital requirement was \$100,000 so long as it operated pursuant to Exchange Act Rule 15c3-3(k)(2)(ii).

Spencer Edwards held G & BT’s funds between approximately September 24, 2013, and October 18, 2013, about 24 days.³²² Thus, during that time, the firm no longer operated pursuant to Exchange Act Rule 15c3-3(k)(2)(ii), and the reduced \$100,000 minimum net capital requirement did not apply.³²³ Spencer Edwards admits that it did not have sufficient excess net capital to meet the higher threshold during the time it retained G & BT’s check.³²⁴ Spencer Edwards nonetheless continued to conduct a securities business in September and October 2013.³²⁵ Therefore, by holding G & BT’s check, the firm violated Exchange Act Rule 15c3-1 and FINRA Rule 2010, from approximately September 25, 2013, to October 18, 2013, as alleged in cause five of the Complaint.

3. Exchange Act Rule 15c3-3

Exchange Act Rule 15c3-3 (commonly known as the Customer Protection Rule) was promulgated to protect customers of a broker-dealer if the broker-dealer becomes insolvent by

³²⁰ *Fox & Co. Inv., Inc.*, 58 S.E.C. 873, 884 (2005).

³²¹ *Dep’t of Enforcement v. Bach*, No. 2011025506901, 2013 FINRA Discip. LEXIS 43, at *17 (OHO Dec. 27, 2013).

³²² “[T]he SEC staff has stated that a firm ‘receives’ customer funds when a registered representative receives a check from a customer.” FINRA Regulatory Notice 15-23, at 4 n.3 (citing Interpretation of Financial Responsibility Rules, Rule 15c3-3, Reserve Formula (Exhibit A – Item 1), Customer Credit Balances/ 18. As such, by holding G & BT’s check, Spencer Edward held customer funds.

³²³ Without qualifying for the Exchange Act Rule 15c3-3(k)(2)(ii) exemption, Spencer Edwards was required to maintain a minimum net capital of \$250,000.

³²⁴ Ans. ¶ 147. The firm maintained net capital of \$131,859 as of September 30, 2013, and \$132,287 as of October 31, 2013. CX-106, at 4; CX-107, at 4.

³²⁵ CX-106; CX-107.

requiring firms to segregate customer assets from firm assets.³²⁶ In this regard, the Rule requires firms to establish a Special Reserve Bank Account for the Exclusive Benefit of Customers and to calculate weekly or monthly the amount that must be maintained in the Reserve Account based on a specified calculation.³²⁷ Pursuant to subsection (k)(2)(i) of the Rule, a broker-dealer may be exempt from the requirements of the Customer Protection Rule if it meets certain requirements, such as it promptly transmits customer funds and securities received in connection with its activities and does not hold customer funds or securities.³²⁸

Pursuant to Spencer Edwards' membership agreement, the firm generally operated in conformity with Exchange Act Rule 15c3-3(k)(2)(ii).³²⁹ During the period that Spencer Edwards held G & BT's check, however, the firm lost its ability to operate pursuant to Exchange Act Rule 15c3-3(k)(2)(ii), and was therefore subject to all requirements of Exchange Act Rule 15c3-3. As such, Spencer Edwards was required, but failed, to make a daily reserve computation and establish and fund a Special Reserve Bank Account for the Exclusive Benefit of Customers, as mandated by Exchange Act Rule 15c3-3.³³⁰ Thus, by holding G & BT's check, the firm violated Exchange Act Rule 15c3-3 and FINRA Rule 2010, from approximately September 25, 2013, to October 18, 2013, as alleged in cause six of the Complaint.

4. Spencer Edwards' Violations of the Exchange Act Were Willful

A member firm willfully violates the Exchange Act and the rules thereunder by intentionally committing the act that constitutes a violation.³³¹ A finding of willfulness does not require a finding that the firm had "knowledge that such actions constitute a rule or statutory violation."³³² Indeed, we need not find that Spencer Edwards intentionally violated any particular Exchange Act Rule to find that it acted willfully.³³³ Thus, if we find that Spencer Edwards knew

³²⁶ See *SEC v. Goble*, 682 F.3d 934, 940 (11th Cir. 2012) (discussing the purpose of the Customer Protection Rule); *Bach*, 2013 FINRA Discip. LEXIS 43, at *23 (same).

³²⁷ See *Bach*, 2013 FINRA Discip. LEXIS 43, at *23.

³²⁸ See Exchange Act Rule 15c3-3(k)(2)(i); *Bach*, 2013 FINRA Discip. LEXIS 43, at *25-26.

³²⁹ CX-108.

³³⁰ CX-106; CX-107; Ans. ¶ 154.

³³¹ *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Dep't of Enforcement v. Merrimac Corp. Sec., Inc.*, No. 2007007151101, 2012 FINRA Discip. LEXIS 43, at *36 (Bd. of Governors May 2, 2012).

³³² *Merrimac Corp. Sec.*, 2012 FINRA Discip. LEXIS 43, at *36 (citations omitted).

³³³ *Richard A. Neaton*, Exchange Act Release No. 65598, 2011 SEC LEXIS 3719, at *20 (Oct. 20, 2011) (holding that a finding of willfulness under the federal securities laws means the person intentionally committed the act that constitutes the violation and does not require that the respondent be aware he is violating the Exchange Act); *Leslie A. Arouh*, Exchange Act Release No. 62898, 2010 SEC LEXIS 2977, at *51 (Sept. 13, 2010) (holding that a finding of willfulness means the person intended to commit the act that constituted the violation, not that he intended to violate a rule or the law).

it was holding G & BT's check, we may find that it acted willfully, regardless of whether the firm also knew that, by holding the check, it violated the Exchange Act or Exchange Act Rules.

Bataille testified that the firm notified him of its receipt of G & BT's check.³³⁴ Lavigne advised Digi, after several inquiries, that the firm had not forwarded the check because it decided to obtain additional information from G & BT.³³⁵ We therefore find that the firm knowingly held G & BT's check between September 2013, when it received the check, and on or around October 18, 2013, when it forwarded the check to Digi. Accordingly, we find that the firm willfully violated Exchange Act Rules, as alleged in causes four, five, and six.

Article III, Section 4 of FINRA's By-Laws incorporates Section 3(a)(39) of the Exchange Act into its definition of "statutory disqualification." Section 3(A)(39)(F) of the Exchange Act incorporates Section 15(b) by reference. Section 15(b)(4)(D) of the Exchange Act makes any willful violation of the Exchange Act or Exchange Act Rules a statutorily disqualifying event. Our finding that Spencer Edwards willfully violated Exchange Act Rules therefore subjects the firm to statutory disqualification from the securities industry.

V. Sanctions

We begin our consideration of sanctions by consulting FINRA's Sanction Guidelines ("Guidelines").³³⁶ The Guidelines provide a list of factors that adjudicators should consider "in conjunction with the imposition of sanctions with respect to all violations."³³⁷ Overall, we find these factors to be aggravating.

Spencer Edwards has a significant disciplinary history. Although the firm's disciplinary history does not involve its investment banking department, which did not exist before the Digi

³³⁴ Tr. 537.

³³⁵ CX-45; CX-46.

³³⁶ FINRA Sanction Guidelines (2018) ("Guidelines"), <http://www.finra.org/industry/sanction-guidelines>. In May 2018, FINRA revised its Guidelines by amending General Principle No. 2 to instruct adjudicators in disciplinary proceedings to consider customer-initiated arbitrations that result in adverse arbitration awards or settlements when assessing sanctions. These revisions apply only to complaints filed on or subsequent to June 1, 2018. *See* Guidelines at 2-3. FINRA made no other revisions to the Guidelines in May 2018. *See* FINRA Regulatory Notice 18-17 (May 2, 2018), <http://www.finra.org/industry/notices/18-17>. Accordingly, we rely on General Principle No. 2 as it read prior to the May 2018 revision.

Spencer Edwards argues that, because the Complaint alleges that violations occurred in 2013 and 2014, it is improper for FINRA to rely on Guidelines enacted subsequent to 2014. We disagree. As noted, we have not applied the one amendment to the Guidelines that FINRA approved in 2018. Otherwise, the 2018 version of the Guidelines supersedes all prior versions. *See* Guidelines at 8. The 2018 Guidelines state, "These guidelines are effective as of the date of publication, and apply to all disciplinary matters, including pending matters." Guidelines at 8.

³³⁷ Guidelines at 7 (Principal Considerations in Determining Sanctions). *See also* *Fuad Ahmed*, Exchange Act Release No. 81759, 2017 SEC LEXIS 3078, at *80 (Sept. 28, 2017) (holding that FINRA Sanction Guidelines serve as a benchmark in the Commission's review of FINRA's sanctions).

offering, its history demonstrates Spencer Edwards' ongoing indifference to rule compliance.³³⁸ Most significantly, the Central Registration Depository ("CRD") reports a March 21, 2017 Extended Hearing Panel Decision in which the Extended Hearing Panel found that, in 2011 and 2012, the firm and several of its associated persons facilitated customer sales of billions of unregistered and non-exempt shares of stock, in violation of Section 5 of the Securities Act of 1933.³³⁹ The Extended Hearing Panel also found that Spencer Edwards failed to implement supervisory procedures adequate to detect unlawful sales of unregistered securities, maintained inadequate anti-money laundering procedures, and failed to retain electronic communications.³⁴⁰ For this misconduct, the Extended Hearing Panel fined Spencer Edwards \$707,000 and suspended the firm from accepting for deposit or liquidation previously deposited certificated securities until an independent consultant determines that the firm has implemented and adopted adequate supervisory procedures.³⁴¹ Spencer Edwards' appeal of this decision is pending before FINRA's National Adjudicatory Council.³⁴²

CRD also reports a 2005 decision in a SEC administrative proceeding finding that the firm failed to supervise and requiring it to pay a civil penalty and disgorgement.³⁴³ CRD also reports that Spencer Edwards agreed to settle eight matters with FINRA between 1999 and 2003. The FINRA allegations of misconduct involved trade reporting and other trading violations and maintenance of inadequate anti-money laundering procedures.³⁴⁴ CRD further reports three state securities actions dating back to the 1990s.³⁴⁵ We find that Spencer Edwards' disciplinary history reveals a troubling pattern of regulatory indifference and noncompliance, which we consider aggravating.³⁴⁶

We also find aggravating the length of time during which Spencer Edwards engaged in the misconduct at issue. The firm recommended and sold Digi notes to customer from September 2013 through August 2014, a period of nearly one year. During this time, the firm's due diligence records were in disarray, due diligence was not adequately performed or supervised, and the firm communicated with potential Digi investors using misleading and unbalanced sales

³³⁸ Guidelines at 7 (Principal Consideration No. 1); *see also Dep't of Enforcement v. Meyers Assoc., LP*, No. 2010020954501, 2016 FINRA Discip. LEXIS 29, at *42-43 (OHO Apr. 27, 2016) (stating that, in assessing sanctions, the Hearing Panel considered the firm's indifference towards compliance), *aff'd*, 2018 FINRA Discip. LEXIS 1 (NAC Jan. 4, 2018), *appeal docketed*, No. 3-18359 (SEC Feb. 20, 2018).

³³⁹ CX-105, at 47-51.

³⁴⁰ CX-105, at 47-51.

³⁴¹ The Extended Hearing Panel also assessed costs of \$16,813.

³⁴² CX-105, at 47.

³⁴³ CX-105, at 29-30.

³⁴⁴ CX-105, at 14-25, 31-44.

³⁴⁵ CX-105, at 11-13, 26-28, 45-46.

³⁴⁶ Guidelines at 7 (Principal Consideration No. 8).

materials. We consider it aggravating that Spencer Edwards engaged in this misconduct over an extended period.³⁴⁷

It is also aggravating that Respondent's misconduct was reckless.³⁴⁸ At every turn, Spencer Edwards exhibited a lack of understanding of its responsibilities to its customers and a startling inattention to detail. The firm built an investment banking department by hiring Lavigne, someone who previously had neither led an investment banking department nor conducted due diligence for an offering. The firm chose Lavigne to run the department, but provided him with no oversight or guidance to follow. Lavigne, on the firm's behalf, did not document his due diligence investigation, note and question red flags, or ask Digi for explanations of inconsistent and incomplete information and documentation. Even when outside counsel highlighted glaring concerns, Lavigne did little to address the concerns and instead allowed the firm to continue sell to customers. The firm also ignored the fact that the inconsistencies, inaccuracies, and incomplete information contained in its due diligence materials were also contained in its marketing materials. Without even hesitating, the firm allowed its registered representatives (including Lavigne) to use misleading, unbalanced, and inaccurate sales literature to recommend and sell Digi notes. Lavigne's supervisor, Flemming, was equally unaware of both her obligations as a supervisor and his conduct. We find the firm's misconduct under causes one, two, and three to be nothing short of reckless.

The firm used the Digi offering to launch what it hoped to be a lucrative investment banking business. It earned a ten percent fee on its sales of \$413,000. We find it further aggravating that Respondent's misconduct resulted in the potential for its own monetary gain.³⁴⁹ We now turn to the Guidelines' recommendations for specific violations.³⁵⁰

A. Unsuitable Recommendations

The Guidelines for unsuitable recommendations recommend a fine of \$2,500 to \$110,000.³⁵¹ The Guidelines also encourage the adjudicator to consider suspending a firm with

³⁴⁷ *Id.* at 7 (Principal Consideration No. 9).

³⁴⁸ *Id.* at 8 (Principal Consideration No. 13).

³⁴⁹ *Id.* at 8 (Principal Consideration No. 16).

³⁵⁰ We acknowledge that Principal Consideration No. 3 suggests we consider whether a member firm respondent voluntarily employed subsequent corrective measures, prior to detection by a regulator, to revise firm procedures to avoid recurrence. Guidelines at 7 (Principal Consideration No. 3). Here, Spencer Edwards hired Larkin in May 2014, just months before the completion of the Digi offering, to improve the firm's due diligence process. We have factored this into our consideration of sanctions, but find that the significant aggravating factors present in this case outweigh this minimal mitigation.

³⁵¹ Guidelines at 95.

respect to a limited set of activities for up to 90 days, and in egregious cases, to consider suspending a firm from any or all activities for longer than 90 days or ordering expulsion.³⁵²

A member firm's responsibility to ensure reasonable-basis suitability before recommending a security to a customer is "an important duty that is fundamental to the relationship between" a firm and its registered representatives and customers.³⁵³ Spencer Edwards abused the trust and confidence its customers placed in it and pushed ahead with sales of Digi notes without even attempting to get a full picture of the offering.

We have already discussed many aggravating factors present in this case. Spencer Edwards' misconduct under cause one is further aggravated by the number of customers (13) to whom it sold Digi notes without having performed sufficient due diligence.³⁵⁴ The firm's due diligence efforts failed at every level. It relied on inconsistent and sometimes irrelevant information provided by Digi without asking for clarification or explanation. The firm seemed to accept the representations of Digi's principals at face value and ignored red flags suggesting significant irregularities. No one at the firm addressed these problems because no one actually supervised Lavigne's due diligence. Finally, we cannot even determine exactly which of Digi's documents Lavigne actually reviewed because he did not document his due diligence and his testimony was internally inconsistent and self-serving.

We cannot determine with any certainty the amount of the customers' losses. None of Spencer Edwards' current or former associated persons knew the current value of the Digi notes or whether any or all of the firm's customers had converted their notes to Digi common stock. It appears, however, that the firm's customers have not benefitted from their Digi note investments because Digi was not able to pay off the notes, and there is no current market for Digi stock. We therefore conclude and find it aggravating that Spencer Edwards' misconduct harmed 13 customers.³⁵⁵ Furthermore, the uncertainty caused by the pending SEC and criminal actions against DM and SD compounds the precariousness of Digi's situation.

In our view, this is an egregious suitability violation accompanied by many aggravating and no mitigating factors. The Guidelines advise that "[t]o address the misconduct effectively in any given case, Adjudicators may design sanctions other than those specified in [the] [G]uidelines."³⁵⁶ The Guidelines also suggest that, where appropriate, we order a respondent to offer rescission to an injured party.³⁵⁷ In light of our conclusion that Spencer Edwards' customers have been harmed by Respondent's misconduct, we order the firm to offer rescission

³⁵² *Id.* There are no principal considerations specific to suitability violations.

³⁵³ *Gomez*, 2018 FINRA Discip. LEXIS 10, at *58.

³⁵⁴ *See* Guidelines at 8 (Principal Consideration No. 17).

³⁵⁵ *See id.* at 7 (Principal Consideration No. 11).

³⁵⁶ *Id.* at 3 (General Principle No. 3).

³⁵⁷ *Id.* at 4 (General Principle No. 5).

to each of the 13 customers who purchased Digi notes. In addition to ordering the firm to offer rescission to its 13 customers, we censure Spencer Edwards,³⁵⁸ fine the firm \$20,000 per customer for a total fine of \$260,000,³⁵⁹ and suspend the firm in all capacities for 45 business days for violations under cause one.

B. False, Misleading, and Unbalanced Communications

The Guidelines for intentional or reckless use of misleading communications recommend a fine of \$10,000 to \$146,000.³⁶⁰ The Guidelines further recommend suspending the firm with respect to any or all activities for up to two years.³⁶¹

As noted above, we find many aggravating factors present in this case. Spencer Edwards used materials provided by Digi to sell the Digi notes. These materials were littered with inconsistencies, innuendo that the firm knew to be false, and incomplete information. The firm, nonetheless, blindly distributed this information and recommended Digi sales based on these materials. Because the firm's due diligence was woefully deficient, its reliance on this sales literature was reckless at best. Indeed, Flemming's own testimony confirmed that Spencer Edwards had no system in place to review marketing materials, so it is unsurprising that the Digi sales literature contained falsities, misleading information, and unbalanced presentations.

The Guidelines specific to the use of misleading communications recommend that we consider whether the violative communications were widely circulated.³⁶² Because Spencer Edwards' records were deficient, it is unclear how many customers received which documents. We know, however, that at least 13 investors and the individuals who attended the firm's two investor conferences received some mix of misleading sales literature. We find this factor aggravating.

We also have considered the instruction in the Guidelines to tailor the sanctions to the specific conduct at issue.³⁶³ Accordingly, we impose a pre-use filing requirement whereby, for six months, the firm must obtain a FINRA staff "no objection" letter on all proposed communications with the public before using the communications. In addition to the pre-use

³⁵⁸ The Guidelines do not specifically recommend whether Adjudicators should impose censures under any of the individual guidelines for specific violations. The Guidelines suggest that, in appropriate circumstances, an Adjudicator may impose a censure. *See* Guidelines at 9 (Censures). Here, we find that the abundance of aggravating factors and dearth of mitigating factors along with the significance of these violations supports our conclusion to censure Spencer Edwards.

³⁵⁹ *See* Guidelines at 4 (General Principle No. 4) ("Depending on the facts and circumstances of a case, however, multiple violations may be treated individually such that a sanction is imposed for each violation.").

³⁶⁰ *Id.* at 81.

³⁶¹ *Id.*

³⁶² *Id.* at 80 (Misleading Communications with the Public Principal Consideration No. 1).

³⁶³ *Id.* at 3 (General Principle No. 3).

filing requirement, we censure Spencer Edwards and fine the firm \$100,000, for violations under cause two.

C. Inadequate Supervision and WSPs

The Guidelines for failure to supervise recommend a fine of \$5,000 to \$73,000. The Guidelines also recommend, in egregious cases, that we consider suspending the firm with respect to any or all activities for up to 30 business days.³⁶⁴ The Guidelines for deficient WSPs recommend a fine of \$1,000 to \$37,000, and in egregious cases, suspending the firm for up to 30 business days and thereafter until the firm adequately amends its WSPs.³⁶⁵

As outlined above, many aggravating factors are present in this case. In addition, the firm ignored many red flag warnings that Lavigne's due diligence was deficient and that he was not sufficiently skilled to run Spencer Edwards' investment banking department. These warnings should have resulted in additional supervisory scrutiny. Instead, the firm allowed Lavigne to operate unsupervised and without any type of written guidance. We find it aggravating that Spencer Edwards ignored many red flags.³⁶⁶

Also aggravating is the nature, extent, and size of the underlying misconduct.³⁶⁷ Spencer Edwards recommended the Digi note offering for nearly one year, held two investor conferences, and sold Digi notes to 13 customers. The firm's deficient supervision enabled the underlying reasonable basis suitability and misleading communication violations to occur.

We also find it aggravating that the firm had deficient WSPs that also enabled the misconduct to occur.³⁶⁸ The WSPs required the firm to conduct adequate due diligence, but did not direct individuals in the firm as to how to achieve that. The WSPs included suggested documents to review, but no specific guidance. Lavigne virtually made it up as he went along. Additionally, the WSPs named Flemming, an individual who admittedly knew nothing about investment banking, as one possible supervisor. It named "outside counsel," an individual who was not registered or associated with the firm, as the other. Flemming ignored Spencer Edwards' investment banking department and did not even know what documents Lavigne included in the firm's due diligence file for Digi. In reality, Flemming did nothing to ensure that Lavigne conducted a thorough due diligence review before allowing the firm to recommend Digi notes.³⁶⁹ Outside counsel, JS, while helpful as an advisor, does not even appear to have known that he was

³⁶⁴ *Id.* at 104.

³⁶⁵ *Id.* at 107.

³⁶⁶ *See id.* at 104 (Failure to Supervise Principal Consideration No. 1).

³⁶⁷ *See id.* at 104 (Failure to Supervise Principal Consideration No. 2).

³⁶⁸ *See id.* at 107 (Deficient WSPs Principal Consideration No. 1).

³⁶⁹ *See id.* at 104 (Failure to Supervise Principal Consideration No. 3).

expected to supervisor Spencer Edwards' head of investment banking, nor was he qualified to do so.

In all, Spencer Edwards' supervisory violations are aggravated by several factors, and we find no mitigating factors. For Spencer Edwards' inadequate WSPs and failure to supervise, violations that we find egregious, we censure the firm, fine it a total of \$110,000,³⁷⁰ suspend the firm in all capacities for 30 business days (to run concurrently with the suspension imposed under cause one), and require the firm to retain an independent qualified consultant, not unacceptable to Enforcement, to review and revise procedures for improved future compliance with supervisory requirements.³⁷¹

D. Holding a Customer Check and Violating the Net Capital and Customer Protection Rules

The Guidelines for violations of Exchange Act Rule 15c2-4 recommend a fine of \$1,000 to \$15,000, and in egregious cases, suspending the firm for up to 30 business days.³⁷² The Guidelines for violations of Exchange Act Rule 15c3-3 recommend a fine of \$1,000 to \$73,000, and a suspension of up to 30 business days, or longer for egregious cases.³⁷³ The Guidelines for violations of Exchange Act Rule 15c3-1 recommend a fine of \$1,000 to \$73,000, and a suspension of up to 30 business days, or longer for egregious cases.³⁷⁴

Spencer Edwards violated the Net Capital and Customer Protection Rules as a result of improperly holding a customer check in connection with the Digi offering. We find that these violations result from a single systemic problem at the firm. We therefore batch these violations for purposes of sanctions and impose one sanction for violations under causes four, five, and six.³⁷⁵

We do not find the principal considerations particular to these violations to be applicable here, except that Spencer Edwards knowingly continued in business while maintaining insufficient net capital.³⁷⁶ This factor is aggravating. Additionally, as noted above, Spencer Edwards has a significant disciplinary history.³⁷⁷ Furthermore, the firm acted knowingly or, at a

³⁷⁰ We arrive at this fine amount by adding together a fine of \$73,000 for the firm's failure to supervise and a fine of \$37,000 for deficient WSPs. *See id.* at 104, 107 (recommended fine amounts).

³⁷¹ *See id.* at 3 (General Principle No. 3).

³⁷² *Id.* at 22.

³⁷³ *Id.* at 27.

³⁷⁴ *Id.* at 28.

³⁷⁵ *Id.* at 4 (General Principle No. 4); *see also Dep't of Enforcement v. Taboada*, No. 2012034719701, 2017 FINRA Discip. LEXIS 29, at *45 (NAC July 24, 2017), *application for review dismissed*, Exchange Act Release No. 82970, 2018 SEC LEXIS 823 (Mar. 30, 2018).

³⁷⁶ *See* Guidelines at 28 (Net Capital Violation Principal Consideration No. 1).

³⁷⁷ *See id.* at 7 (Principal Consideration No. 1).

minimum, recklessly.³⁷⁸ Spencer Edwards received G & BT's check and chose to hold it for weeks because the firm wanted additional information from its customers. The firm's procedures were sloppy. No one, including Flemming, the firm's chief financial officer, even knew who at the firm held the check. That said, we acknowledge that these violations were limited in duration and impact. Accordingly, for violations under causes four, five, and six, we censure Spencer Edwards and fine the firm \$25,000.

VI. Order

We find that Spencer Edwards, Inc. recommended and sold Digi Outdoor Media, Inc., two-year notes in a private placement to 13 customers without having a reasonable basis to believe that the investments were suitable for any investor, in violation of FINRA Rules 2111 and 2010. We also find that Spencer Edwards distributed false, unbalanced, and misleading communications about the Digi notes to potential investors, in violation of FINRA Rules 2210 and 2010. Furthermore, we find that Spencer Edwards had inadequate written supervisory procedures in place and failed adequately to supervise due diligence conducted in connection with the Digi note offering, in violation of NASD Rule 3010 and FINRA Rule 2010. Finally, we find that the firm failed to promptly transmit a customer check for investment in the Digi note offering and, as a result, maintained insufficient net capital and inadequate customer protections, in willful violation of Exchange Act Rules 15c2-4, 15c3-1, and 15c3-3, and FINRA Rule 2010.³⁷⁹

For these violations, we censure Spencer Edwards, suspend the firm in all capacities for 45 business days, fine the firm a total \$495,000, order the firm to offer rescission to the 13 customers who purchased Digi notes, impose a six-month pre-use filing requirement for all of the firm's communications with customers, and require the firm to retain an independent outside consultant, not unacceptable to Enforcement, to review and revise the firm's supervisory procedures. If this decision becomes FINRA's final disciplinary action, the suspension shall become effective with the opening of business on Monday, January 7, 2019. The pre-use filing requirement will take effect immediately after completion of the suspension. We impose these sanctions as follows:

- For recommending and selling Digi notes to 13 customers without having a reasonable basis to believe that the investments were suitable, we censure Spencer Edwards, fine the firm \$260,000, order the firm to offer rescission to the 13 customers who purchased notes, and suspend the firm in all capacities for 45 business days.
- For distributing false, unbalanced, and misleading communications about the Digi notes to potential investors, we censure Spencer Edwards, fine the firm \$100,000,

³⁷⁸ See *id.* at 8 (Principal Consideration No. 13).

³⁷⁹ The Hearing Panel considered and rejected without discussion all other arguments by the parties.

and impose a six-month pre-use filing requirement on the firm's communications with customers.

- For maintaining inadequate written supervisory procedures and failing to adequately supervise due diligence, we censure Spencer Edwards, fine the firm \$110,000, suspend the firm in all capacities for 30 business days (to run concurrently with the 45-day suspension already imposed), and order the firm to retain an independent outside consultant, not unacceptable to Enforcement, to review and revise the firm's supervisory procedures.
- For failing to transmit promptly a customer check for investment in the Digi note offering and, as a result, maintaining insufficient net capital and inadequate customer protections, we censure Spencer Edwards and fine the firm \$25,000.

Spencer Edwards is also ordered to pay the costs of the hearing in the amount of \$7,529.55, which includes a \$750.00 administrative fee and \$6,779.55 for the cost of the hearing transcript. The costs shall be payable on a date set by FINRA, but not less than 30 days after this decision becomes FINRA's final disciplinary action in this matter.



Carla Carloni
Carla Carloni
Hearing Officer
For the Extended Hearing Panel

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