

BEFORE THE NATIONAL ADJUDICATORY COUNCIL  
FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of

Department of Enforcement,

Complainant,

vs.

Thaddeus J. North  
New Milford, CT,

Respondent.

DECISION

Complaint No. 2010025087302

Dated: March 15, 2017

**Respondent failed to establish and maintain a reasonable supervisory system for the review of electronic correspondence and failed to adequately review electronic correspondence at member firm. Respondent also failed to report an associated person's relationship with a statutorily disqualified person. Held, findings and sanctions modified.**

**Appearances**

For the Complainant: Leo F. Orenstein, Esq., Sarah B. Belter, Esq., Mark J. Fernandez, Esq.,  
Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Constance J. Miller, Esq.

**Decision**

Thaddeus J. North appeals a December 1, 2015 Hearing Panel decision pursuant to FINRA Rule 9311. The Hearing Panel found that North failed to report a relationship with a statutorily disqualified person, in violation of NASD Rule 3070(a)(9) and FINRA Rule 2010; failed to establish a reasonable supervisory system for the review of electronic correspondence, in violation of NASD Rule 3010 and FINRA Rule 2010, and in willful violation of MSRB Rules G-27(b) and (e) and G-17; and failed to adequately review electronic correspondence, in violation of NASD Rule 3010(b) and FINRA Rule 2010, and in willful violation of MSRB Rules G-27(a) and G-17. The Hearing Panel assessed sanctions by cause. For the first violation, the Hearing Panel fined North \$10,000 and suspended him from association with any FINRA member firm in all principal capacities for 30 business days. For the second violation, the Hearing Panel fined North \$10,000 and censured him. For the third violation, the Hearing Panel fined North \$20,000 and suspended him from association with any FINRA member firm in all

principal capacities for two months. The Hearing Panel ordered that the suspensions run consecutively. After an independent review of the record, we modify the Hearing Panel's findings of liability and the sanctions it imposed.

I. Background

A. General Background

North first associated with a FINRA member firm in 1994. From February 2008 to August 2011, North was associated with Southridge Investment Group LLC ("Southridge"). He was registered as a general securities principal, registered options principal, general securities sales supervisor, general securities representative, equity trader limited representative, and investment banking limited representative. During the relevant period, July 2009 to August 2011, North served as Southridge's chief compliance officer ("CCO"). Southridge had approximately 50 registered representatives during the relevant period in at least three branch offices. North was located in Southridge's home base office in Ridgefield, Connecticut. North was responsible for reviewing all of Southridge's electronic communications. North is currently registered with another member firm.

B. King Enters into a Business Relationship with Cowle, a Statutorily Disqualified Person

Leslie King was associated with Southridge during the relevant period and registered as a general securities representative, general securities principal, and municipal securities principal. King primarily effected inter-dealer and customer trades in municipal bonds and government securities. King and her sister were the only registered persons in Southridge's Plano, Texas branch office.

Prior to working at Southridge, King was associated with Southwest Texas Capital, LLC, where she worked with Thomas Cowle, a registered general securities representative. In November 2007, FINRA found that Cowle willfully failed to disclose federal tax liens on his Uniform Application for Securities Industry Registration or Transfer ("Form U4"). Consequently, Cowle was statutorily disqualified from association with any FINRA member.<sup>1</sup> Southwest Texas Capital, LLC terminated Cowle in June 2009, and he has not since been registered with a FINRA member firm.

Sometime prior to July 2009, William Schloth, Southridge's chief executive officer, considered hiring both King and Cowle as a registered representatives. At Schloth's request, North ran a report on Cowle in the Central Registration Depository ("CRD"®), which reflected that Cowle was statutorily disqualified. According to North, Schloth decided not to hire Cowle

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<sup>1</sup> Under Article III, Section 4 of FINRA's By-Laws and Section 3(a)(39)(F) of the Securities Exchange Act of 1934 (the "Exchange Act"), individuals are subject to a statutory disqualification if they willfully made a false or misleading statement with respect to any material fact in any application for membership. 15 U.S.C. § 78c(a)(39)(F).

because the firm would need to sponsor him through the FINRA continuing membership process, which Schloth considered time consuming and uncertain. Schloth nonetheless decided to hire King.

On July 8, 2009, King completed new hire paperwork and associated with Southridge the next day. That same month, King and her husband formed King Asset Management (“KAM”), which she disclosed as an outside business activity to Southridge. King, on behalf of KAM, entered into a service agreement dated July 15, 2009, with Ultimate Tier Advisors, LLC (“UTA”), a company owned by Cowle.<sup>2</sup> Under the agreement, in exchange for payment as an independent contractor by KAM, UTA would deliver the following services: introduce KAM to street brokers in the securities industry and provide consultation, instruction, and training to King. The agreement recognized that the services were not limited to those described, and that KAM and UTA were able to discuss additional business opportunities and compensation. According to the agreement, UTA would remit invoices to KAM for services that UTA provided. King, on behalf of KAM, was the only party who signed the agreement.

Between July 2009 and September 2011, Cowle issued UTA invoices to KAM, and KAM paid at least 42 invoices totaling \$605,365 for various services.

#### C. FINRA’s Examinations of Southridge

In March 2010, FINRA staff conducted a routine examination of Southridge. During the course of the examination, FINRA staff requested financial information about Southridge’s Plano, Texas branch office. North obtained from King invoices that UTA had issued to KAM. North believes he briefly looked over the invoices and then gave them to Schloth, who also was King’s supervisor and the Plano branch manager. Schloth then produced the invoices to FINRA. After receiving the invoices, FINRA requested any agreements relating to them. North then saw the KAM-UTA service agreement for the first time, and either he or Schloth produced it to FINRA. The invoices and service agreement referenced UTA only, not Cowle. North was not familiar with UTA, and he did not know Cowle was involved with UTA. North did not ask King any questions about the service agreement or conduct an investigation regarding UTA.

Based on a regulatory tip that Cowle was being paid commissions for client referrals and other activities by King and another person, FINRA staff began an investigation of Southridge in December 2010. FINRA, pursuant to FINRA Rule 8210, requested additional information concerning King and Cowle’s relationship. Schloth, on behalf of Southridge, produced additional UTA invoices received after the March 2010 FINRA examination in response to the FINRA Rule 8210 request. According to North, he first learned in December 2010 that Cowle was involved with UTA and was the one invoicing King during a conversation with Schloth related to FINRA’s investigation. Schloth, at the time, was adamant that UTA was not engaging in any misconduct by invoicing KAM and King. North did not conduct an independent examination, and he never made an electronic filing to FINRA pursuant to NASD Rule 3070 reporting King’s relationship with UTA and Cowle.

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<sup>2</sup> Cowle formed UTA in May 1999.

D. Electronic Communications at Southridge

North was responsible for reviewing electronic communications of Southridge. Southridge's electronic communications consisted of firm emails, Bloomberg messages, and Bloomberg chats during the relevant period.<sup>3</sup> Southridge relied on a vendor, Smarsh, Inc. ("Smarsh"), to archive its communications and provide Southridge the ability to review the communications. Both Southridge's 2008 written supervisory procedures, effective until November 21, 2010, and its 2010 written supervisory procedures, effective thereafter, provided that Southridge utilized Smarsh for the archival and review platform of its electronic communications. Smarsh archived Southridge's email, Bloomberg messages, and Bloomberg chats in three separate repositories. Southridge had access to the Smarsh Management Console ("SMC") to review firm emails and Bloomberg communications.

Smarsh's system recorded searches run by users, including their search history; message review history; the identity of the user who logged onto the system; the length of time of the search; the number of messages located through the search; and the number of messages actually reviewed by the user. All of this information was recorded in Smarsh's computer database automatically in "real time." North was the only person at Southridge who utilized the SMC.

II. Procedural History

On July 15, 2013, the Department of Enforcement ("Enforcement") filed a five-cause complaint against North, King, and Schloth. Prior to the hearing, Schloth and King settled the charges against them, so the hearing proceeded solely on the allegations against North. Only the third, fourth, and fifth causes of action were alleged against North. In cause three, Enforcement alleged that North failed to report King's relationship with a statutorily disqualified person, in violation of NASD Rule 3070(a)(9) and FINRA Rules 4530(a)(1)(H) and 2010. In cause four, Enforcement alleged that North failed to establish and maintain a supervisory system that was reasonably designed to achieve compliance with applicable securities laws related to the review of electronic correspondence, in violation of NASD Rule 3010(a) and (d) and FINRA Rule 2010, and in willful violation of MSRB Rules G-27(b) and (e) and G-17.<sup>4</sup> In cause five, Enforcement alleged that North failed to adequately review electronic correspondence, in violation of NASD

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<sup>3</sup> This decision refers to Bloomberg messages and Bloomberg chats collectively as Bloomberg communications. Some Southridge brokers used Bloomberg communications to communicate in connection with municipal bond transactions.

<sup>4</sup> MSRB rules are applicable because this case involves municipal securities subject to MSRB regulation. FINRA's By-Laws provide that its members and persons registered with members agree to comply with MSRB Rules, and FINRA is authorized to impose sanctions for violations of MSRB Rules. FINRA By-Laws Article IV, § 1(a)(1) (agreement by firms); FINRA By-Laws Article V, § 2(a)(1) (agreement by registered persons); FINRA By-Laws Article XIII, § 1(b) (authorization to impose sanctions for violation of MSRB Rules).

Rule 3010(b) and FINRA Rule 2010, and in willful violation of MSRB Rules G-27(a) and (c) and G-17.<sup>5</sup>

After a two-day hearing, the Hearing Panel issued its decision on December 1, 2015. The Hearing Panel found that North engaged in the misconduct as alleged in the complaint, with the exception of the allegation in cause three that North's conduct also violated FINRA Rule 4530. For the three violations, the Hearing Panel fined North a total of \$40,000, imposed a 30-business-day suspension in any principal capacity followed by an additional two-month suspension in any principal capacity, and censured him. This appeal followed.

### III. Discussion

For the reasons set forth below, we modify the Hearing Panel's liability findings.

#### A. North Failed to Report King's Relationship with a Statutorily Disqualified Person

The Hearing Panel found that North failed to report King's relationship with a statutorily disqualified person, in violation of NASD Rule 3070(a)(9)<sup>6</sup> and FINRA Rule 2010. We affirm this finding.

NASD Rule 3070(a)(9), effective through June 30, 2011, required a member firm to report to FINRA whenever it, or one of its associated persons, was "associated in any business or financial activity with any person who is subject to a 'statutory disqualification' . . . and the member knows or should have known of the association." NASD Rule 3070(b) provided that "[e]ach member shall report to [FINRA] not later than 10 business days after the member knows or should have known of the existence of any of the conditions set forth in paragraph (a) of this rule." In both the 2008 and 2010 written supervisory procedures, North was responsible for Southridge's compliance with NASD Rule 3070 reporting requirements. In the 2008 procedures, the compliance officer was required to file the disclosure event with FINRA. The 2010 procedures, which specifically identified North as CCO, provided that the CCO was responsible for filing events under NASD Rule 3070.

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<sup>5</sup> The conduct rules that apply in this case are those that existed at the time of the conduct at issue.

<sup>6</sup> On July 1, 2011, FINRA adopted FINRA Rule 4530, which was modeled after and replaced NASD Rule 3070. *See FINRA Regulatory Notice 11-06*, 2011 FINRA LEXIS 8 (Feb. 2011). FINRA Rule 4530(a)(1)(H)(ii) is narrower than NASD Rule 3070(a)(9) and only requires a member to report if it or any of its associated persons is "involved in the sale of any financial instrument, the provision of any investment advice or the financing of any such activities with any person that is subject to a 'statutory disqualification.'" Whereas the complaint alleged that North's conduct violated both NASD Rule 3070 and FINRA Rule 4530, the Hearing Panel found that North violated only NASD Rule 3070. Because Enforcement did not cross-appeal, we do not address whether North's misconduct violated FINRA Rule 4530.

It is undisputed that North never filed with or electronically reported to FINRA King's business activity with Cowle, a person subject to statutory disqualification. King associated with Southridge on July 9, 2009, and entered into a business activity with Cowle on July 15, 2009. The question is when North knew or should have known of King's association with Cowle, thereby requiring North to report the association to FINRA. *See* NASD Rule 3070(a).

We agree with the Hearing Panel that the evidence does not support the conclusion that North knew or should have known about King's relationship with Cowle as of July 2009. Whereas King disclosed KAM in her July 8, 2009 hiring documents, there is no mention of its relationship with UTA. Indeed, the KAM-UTA service agreement was not executed until more than a week later. Further, there is no evidence that North was aware or should have suspected that King had an ongoing relationship with Cowle in July 2009 when North ran Cowle's CRD report or had discussions with Schloth regarding Cowle's possible employment.

North asserts that he learned of King's relationship with Cowle in December 2010 during FINRA's later investigation. But North should have learned about King's relationship with Cowle shortly after March 2010, after seeing the KAM-UTA service agreement and the invoices that Southridge produced to FINRA in March 2010. Although the service agreement and invoices did not reference Cowle, North should have sought additional details about King's business dealings with UTA, in particular because of certain existing red flags. First, the monthly invoices submitted by UTA were for considerable amounts with little description about the services being provided. Among other things, the invoices generally referenced "consultations," "phone consultations," various "trainings," and "introductions" to various people. From July 2009 to February 2010, the UTA invoices totaled \$151,800, and included monthly invoices for significant amounts (e.g., \$39,800 and \$32,500). Second, the services agreement, under which the invoices were issued, was vague. It was one page, and it only was executed by King on behalf of KAM. No one executed the agreement on behalf of UTA, and it did not identify anyone associated with the company. Had North investigated and inquired further about UTA, he would have discovered the connection to Cowle and his ongoing relationship with King.

On appeal, North does not dispute that he was responsible for filing events under NASD Rule 3070 at Southridge but instead makes various arguments to excuse his misconduct, all of which we reject. First, North argues the NASD Rule 3070 requires "brokers" to report certain events to their member firm, so that the member firm's designated person can report the event to FINRA within 10 days. Because North obtained the service agreement and invoice while gathering information to respond to FINRA's inquiry, North asserts that he learned of King's relationship from "Enforcement's superior knowledge" rather than a "broker registered or doing business with the firm."

North's argument is based on a misreading of the rule. The reporting obligations of NASD Rule 3070 are not limited to instances raised by "brokers." Rather, the Rule provides that "[e]ach member shall promptly report to [FINRA]" when "the member knows or should have

known” that its associated person is associated with a statutorily disqualified person.<sup>7</sup> NASD Rule 3070(a). When King provided North with the service agreement and invoices in March 2010, in connection with FINRA’s inquiry, he should have learned about King’s relationship with Cowle, triggering North’s obligation to report it to FINRA.<sup>8</sup>

Second, North argues that a member has a “duty to report” only when the regulator “does not have or is not likely to obtain the information unless the member firm discloses it.” This argument also fails. Whether FINRA may have been aware of information that is subject to reporting under NASD Rule 3070(a) does not excuse noncompliance with NASD Rule 3070’s reporting requirements.<sup>9</sup> *See, e.g., Dep’t of Enforcement v. Inv. Mgmt. Corp.*, Complaint No. C3A010045, 2003 NASD Discip. LEXIS 47, at \*21-23 n.21 (NASD NAC Dec. 15, 2003) (“Even if NASD had received notice through [another means] in a timely manner, that does not excuse the respondents from their obligation to notify NASD under Rule 3070.”). On appeal, North argues that *Investment Management Corporation* is inapplicable because “Enforcement investigators and attorneys had specific knowledge” of King’s business relationship with Cowle whereas the regulator in *Investment Management Corporation* “did not have actual or superior knowledge” of the “separately adjudicated judicial proceeding.” North misreads our holding in that decision. The case holds that even if FINRA has knowledge of a triggering event, the member firm is not excused from its reporting obligations under NASD Rule 3070.

North failed to report to FINRA that King was associated in a business activity with a statutorily disqualified person. We therefore affirm the Hearing Panel’s findings that North violated NASD Rule 3070(a) and FINRA Rule 2010.<sup>10</sup>

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<sup>7</sup> NASD Rule 3070, like other FINRA and NASD Rules, is made applicable to associated persons by FINRA Rule 0140.

<sup>8</sup> Contrary to North’s arguments, North was not required to learn about King’s relationship from Schloth, King, or Cowle, or another broker to be liable under the rule. We note, however, that North should have learned shortly after March 2010 about the relationship based on materials provided to him by King in March 2010, and North indeed did learn about the relationship during a conversation with Schloth in December 2010.

<sup>9</sup> We note, however, that FINRA began investigating King’s relationship with Cowle in December 2010 based on a regulatory tip, but we find that North should have known about the relationship, and reported it to FINRA, eight months prior.

<sup>10</sup> FINRA Rule 2010 provides “[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.” It is well settled that a violation of another FINRA rule is a violation of FINRA Rule 2010. *See William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at \*26 (July 2, 2013), *aff’d sub nom., Birkelbach v. SEC*, 751 F.3d 472 (7th Cir. 2014).

B. North Failed to Establish a Reasonable Supervisory System for the Review of Electronic Correspondence

The Hearing Panel found that North failed to establish a reasonable supervisory system for the review of electronic correspondence, in violation of NASD Rule 3010(a) and (d) and FINRA Rule 2010, and in willful violation of MSRB Rules G-27(b) and (e) and G-17. We modify these findings.

“Establishing, maintaining, and enforcing written supervisory procedures is a cornerstone of self-regulation within the securities industry.” *NASD Notice to Members 98-96*, 1998 NASD LEXIS 121, at \*1 (Dec. 1998). NASD Rule 3010(a) required FINRA members to “establish and maintain” a supervisory system that is reasonably designed to achieve compliance with applicable securities laws and FINRA rules.<sup>11</sup> NASD Rule 3010(d) required member firms to establish written procedures “for the review by a registered principal of incoming and outgoing written and electronic correspondence of its registered representatives with the public relating to the investment banking or securities business of such member.” NASD Rule 3010(d)(1). The rule further required that a member firm develop written procedures that are “appropriate to [the member’s] business, size, structure, and customers for the review of incoming and outgoing written (i.e., non-electronic) and electronic correspondence with the public relating to its investment banking or securities business.” NASD Rule 3010(d)(2). MSRB Rule G-27 is substantially similar to NASD Rule 3010 in the relevant parts but is applicable to dealers of municipal securities. *Compare* MSRB Rules G-27(b), (e), *with* NASD Rule 3010(a), (d).<sup>12</sup>

North does not dispute that he was responsible for establishing and maintaining Southridge’s written supervisory procedures.<sup>13</sup> The 2008 written supervisory procedures, in

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<sup>11</sup> Effective December 1, 2014, NASD Rule 3010 was moved into the Consolidated FINRA Rulebook as FINRA Rule 3110. *See FINRA Notice to Members 14-10*, 2014 FINRA LEXIS 17 (Mar. 2014).

<sup>12</sup> MSRB Rule G-27(b), in the relevant part, provides: “Each dealer shall establish and maintain a system to supervise the municipal securities activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Board rules.” MSRB Rule G-27(e)(ii), in the relevant part, provides: “Each dealer shall develop written procedures that are appropriate to its business, size, structure, and customers for the review of incoming and outgoing written (i.e., non-electronic) and electronic correspondence with the public relating to its municipal securities activities.”

<sup>13</sup> The 2008 written supervisory procedures designated the compliance officer as the person responsible for maintaining the procedures, whereas the 2010 written supervisory procedures designated North, by title and name, as the person responsible for reviewing and maintaining the procedures. The 2010 procedures also provided that the CCO was responsible for ensuring that Southridge had appropriate policies and procedures concerning electronic communication.

effect until November 21, 2010, stated that Smarsh provided electronic messaging archiving and a platform for reviewing the archived messages, and “[t]he CCO reviews a sample of daily electronic communications by either selecting ‘random message’ or sometimes by individual [registered representative] mailbox.” The 2008 procedures did not specify the frequency of review, the size of the review sample, or how the review should be documented. The 2010 procedures provided that the firm would employ a “risk-based approach” and that the CCO will “[u]tilize SMARSH to review random samples of emails,” “[u]tilize appropriate lexicon that can be amended, as necessary,” and “[m]aintain appropriate documentation of electronic communications review (SMARSH).” The 2010 written supervisory procedures were incomplete and provided that “[a]n appropriate random sampling (ENTER PERCENTAGE OR OTHER DEFINABLE SAMPLE SIZE) of all copies of e-mail will be reviewed.”

Both sets of Southridge’s written supervisory procedures relating to the review of electronic correspondence were inadequate and contrary to guidance issued by FINRA. When a member firm chooses to review its electronic correspondence through a random sampling technique, FINRA does not prescribe a minimum or fixed percentage. FINRA, however, advises firms that the amount of electronic correspondence reviewed “must be reasonable given the circumstances (for example, member size, nature of business, customer base, and individual employee circumstances).” *FINRA Regulatory Notice 07-59*, 2007 FINRA LEXIS 58, at \*32 (Dec. 2007). The procedures should prescribe “reasonable timeframes within which supervisors are expected to complete their reviews of correspondence.” *Id.* at \*35. And the procedures should “identify how supervisory reviews will be conducted and documented” and “specify the minimum frequency of the reviews for each type of correspondence.” *NASD Notice to Members 98-11*, 1998 NASD LEXIS 12, at \*5 (Jan. 1998).

Southridge’s general and, at times, incomplete procedures fell well short of FINRA guidance and thus were unreasonable. Southridge had as many as 50 registered representatives in various offices, so monitoring electronic correspondence was an important element of supervision at the firm. The procedures, however, were deficient considering the size of the firm and its business model. Both sets of procedures lacked specificity regarding the size of the review sample, method, frequency of the review, and the documentation of the review. *See FINRA Regulatory Notice 07-59*, 2007 FINRA LEXIS 58, at \*32; *NASD Notice to Members 98-11*, 1998 NASD LEXIS 12 at \*5. Most glaringly, the 2010 procedures were incomplete with boilerplate language that was never tailored to Southridge. *See Dep’t of Enforcement v. Legacy Trading Co.*, Complaint No. 2005000879302, 2010 FINRA Discip. LEXIS 20, at \*35 (FINRA NAC Oct. 8, 2010) (finding firm’s written procedures were “incomplete, in draft form, and not tailored specifically to [its] business”). Contrary to North’s assertions on appeal, the lack of specificity in the 2008 and 2010 written supervisory procedures can be, and indeed is, a basis for North’s liability for inadequate supervisory procedures.

We, like the Hearing Panel, find that North failed to establish and maintain a reasonable supervisory system for the review of electronic correspondence. We therefore affirm the Hearing Panel’s finding that North violated NASD Rule 3010, FINRA Rule 2010, and MSRB Rule G-27(b) and (e). Enforcement alleged that North’s violation of MSRB Rule G-27 was willful. A violation is deemed willful if “the person charged with the duty knows what he is doing.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). To find that North’s actions were willful, therefore, we examine if he voluntarily engaged in the misconduct. We need not

find that he intentionally violated MSRB rules or acted with a culpable state of mind. *See id.* (finding that the law does not require that the willful actor “also be aware that he is violating one of the Rules or Acts”) (internal quotations omitted); *see also Jason A. Craig*, Exchange Act Release No. 59137, 2008 SEC LEXIS 2844, at \*13 (Dec. 22, 2008) (finding that the law merely requires that the willful actor “voluntarily committed the acts that constituted the violation”). Here, North’s actions—i.e., establishing and maintaining Southridge’s deficient written supervisory procedures—were voluntary. Thus, we conclude that his violation of MSRB Rule G-27 was willful.<sup>14</sup>

The Hearing Panel also found that North’s conduct violated MSRB Rule G-17, as alleged in the complaint. We disagree. MSRB Rule G-17 provides that, “[i]n the conduct of its municipal securities activities or municipal advisory activities, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.” MSRB Rule G-17 encompasses both an antifraud prohibition and a duty to deal fairly. *See Notice of Filing of Proposed Rule Change Relating to Rule G-17*, Exchange Act Release No. 45361, 2002 SEC LEXIS 304, at \*1-2 (Jan. 30, 2002). “[T]he duty to ‘deal fairly’ is intended to ‘refer to the customs and practices of the municipal securities markets, which may, in many instances differ from the corporate securities markets.’ As part of a dealer’s obligation to deal fairly, the MSRB has interpreted the rule to create affirmative disclosure obligations for dealers.” *Id.* Neither fraud nor the failure to deal fairly is implicated here, so we do not impose liability for a violation of MSRB Rule G-17.<sup>15</sup> *See Dep’t of Enforcement v. Sisung Sec. Corp.*, Complaint No. C05030036, 2006 NASD Discip. LEXIS 16, at \*53 n.40 (NASD NAC Aug. 28, 2006) (citations omitted) (declining to find liability under MSRB Rule G-17 for recordkeeping, reporting, and soliciting violations), *aff’d in part*, Exchange Act Release No. 56741, 2007 SEC LEXIS 2562 (Nov. 5, 2007). *But see Anthony A. Grey*, Exchange Act Release No. 75839, 2015 SEC LEXIS 3630, at \*10-16 (Sept. 3, 2015) (affirming FINRA’s finding of a violation of MSRB Rules G-17 and G-30 for interpositioning and markups).

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<sup>14</sup> Under Sections 3(a)(39) and 15(b)(4)(D) of the Exchange Act, broker-dealers and associated persons are subject to disqualification from the securities industry for willful violations of the federal securities laws or MSRB rules. *See* 15 U.S.C. § 78c(a)(39), 15 U.S.C. § 78o(b)(4)(D). Because North willfully violated MSRB rules, he is subject to statutory disqualification. *See* 15 U.S.C. § 78c(a)(39), 15 U.S.C. § 78o(b)(4)(D).

<sup>15</sup> Like the Hearing Panel, we find North’s conduct was negligent—he knew he was responsible for establishing and maintaining Southridge’s written supervisory procedures and he should have known the procedures with respect to the review of electronic communications were deficient. Our finding, however, does not implicate liability under MSRB Rule G-17 in this instance.

C. North Failed to Adequately Review Electronic Correspondence

The Hearing Panel found that North failed to adequately review electronic correspondence, in violation of NASD Rule 3010(b), FINRA Rule 2010, MSRB Rule G-27(a) and (c), and MSRB Rule G-17. We modify these findings.

North admits that he never reviewed any Bloomberg communications during the relevant period. To prove North's violative conduct with respect to emails, Enforcement relied on testimony, Southridge's written supervisory procedures, and reports generated by Smarsh reflecting the frequency and scope of North's review of Firm emails (the "Smarsh reports"). During the proceeding below, North argued that Smarsh failed to properly archive Southridge's electronic correspondence, so that Southridge's emails were "spoliated," and that the Smarsh reports reflecting the frequency and scope of North's review of Southridge's emails were unreliable. The Hearing Panel rejected North's arguments. On appeal, North argues that the Hearing Panel's rejection of these arguments was in error. We disagree.

1. North's Review of Electronic Correspondence Was Inadequate

A FINRA member must implement and enforce its supervisory system and written procedures reasonably in light of the circumstances presented. *See Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at \*33 (Dec. 19, 2008). NASD Rule 3010(b) required members to "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons." NASD Rule 3010(b)(1). MSRB Rule G-27 is substantially similar to NASD Rule 3010 in the relevant parts. *Compare* NASD Rule 3010(b), *with* MSRB Rule G-27(a) and (c).<sup>16</sup>

Southridge's 2008 and 2010 written supervisory procedures required North, as CCO, to review all of Southridge's electronic correspondence, including its associated persons' electronic correspondence. During the relevant period, July 2009 through August 2011, North was the only person at Southridge who accessed the SMC, or Smarsh's platform, to review Southridge's electronic correspondence. The SMC recorded search and retrieval activity, and North relied on the SMC to document his review of electronic correspondence. Smarsh archived Southridge's email, Bloomberg messages, and Bloomberg chats in three separate repositories. To review all of Southridge's electronic correspondence, a user would need to run a separate search in each repository. North admitted in his answer and testified that he was unaware that he needed to run separate searches to review Bloomberg communications.

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<sup>16</sup> MSRB Rule G-27(a) provides: "Each broker, dealer and municipal securities dealer ('dealer') shall supervise the conduct of the municipal securities activities of the dealer and its associated persons to ensure compliance with Board rules and the applicable provisions of the Act and rules thereunder." MSRB Rule G-27(c), in the relevant part, provides: "Each dealer shall adopt, maintain and enforce written supervisory procedures reasonably designed to ensure that the conduct of the municipal securities activities of the dealer and its associated persons are in compliance as required in section (a) of this rule."

North's review of Southridge's electronic correspondence during the relevant period was inadequate. First, North admits he did not review any Bloomberg communications during the relevant period, which in and of itself is sufficient to find him liable under the relevant rules. Second, North's email reviews also were inadequate. From July 1, 2009, through September 1, 2011, North conducted email reviews 36 times. In 13 of the 27 months comprising this period, he reviewed no emails. There were also long stretches of time—ranging from three to five months—in which he failed to review any emails. From June 2010 through August 2011, North reviewed emails only six times. North also admits that he never subjected King's electronic communications to an amplified review after March 2010, when he saw the KAM-UTA service agreement and invoices (or even after December 2010, when he learned about King's relationship with Cowle). He should have done so in accordance with Southridge's written supervisory procedures and the applicable rules.<sup>17</sup>

North's review of electronic correspondence failed to satisfy the requirements of NASD Rule 3010 and MSRB Rule G-27.<sup>18</sup> His misconduct also violated FINRA 2010. Because his actions were voluntary, we find that his violation of MSRB Rule G-27 was willful.<sup>19</sup>

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<sup>17</sup> On appeal, North asserts that “[t]he Smarsh Reports created the illusion that Mr. North was the only principal responsible for heightened supervision. The reports were used to infer that Mr. North avoided implementing heightened supervision over [King,] because the reports show no changes in Mr. North's Email review.” We agree with this inference created by the Smarsh reports. The 2010 written supervisory procedures required North to employ a “risk-based approach” and “[u]tilize appropriate lexicon that can be amended, as necessary.” When North learned about the KAM-UTA service agreement and invoices in March 2010, he should have employed a risk-based approach and amended his search lexicon to target King's electronic communications in light of the red flags. He failed to do so. Although North argues that any decision to implement heightened supervision over an employee not directly supervised by North would have required a decision by the firm's management, this fact did not prevent North from employing a risk-based approach when conducting electronic correspondence reviews, as provided in Southridge's written supervisory procedures.

North also argues that he was unable to learn about King's relationship with Cowle because “the Emails were intentionally not archived and thereby not available for compliance actions.” We note again that both North testified and the Smarsh reports show that emails responsive to North's searches on the Smarsh SMC were produced for his review. Regardless of whether other emails were not properly archived, North admits that he did not even attempt to investigate the relationship after March 2010, which is sufficient for our purposes with respect to his inadequate review of electronic communication.

<sup>18</sup> We conclude for the reasons explained above that North's misconduct did not also violate MSRB Rule G-17. *See supra* Part III.B n.14.

<sup>19</sup> As a result of his willful violation of MSRB rules, North is subject to statutory disqualification. *See* 15 U.S.C. § 78c(a)(39), 15 U.S.C. § 78o(b)(4)(D). *See supra* Part III.B.

## 2. North's Procedural Arguments Related to Electronic Correspondence Fail

The majority of North's arguments on appeal relate to evidence spoliation and excluded expert testimony related to electronic communications and Southridge emails specifically. We address these arguments in turn.

### a. Procedural Background Relevant to Evidence Spoliation Claims

It is necessary to review additional procedural background to address North's arguments on appeal. Enforcement filed a five-cause complaint against North, King, and Schloth on July 15, 2013. Schloth settled within two months, so the case proceeded against only North and King. The sole charge against King was that she aided and abetted violations of the registration requirements of Section 15 of the Exchange Act through her business relationship with a statutorily disqualified person (i.e., Cowle). Initially, North was pro se before he hired King's counsel, who represented him throughout the proceeding thereafter and continues to represent him on appeal.

On August 11, 2014, North and King, through counsel, filed a motion for summary disposition, claiming that there had been "intentional spoliation in bad faith of large quantities of relevant evidence." They proffered two experts, AT and DS, who asserted that King's emails had been altered. In its opposition, Enforcement argued that North and King's spoliation claims were speculative and false and sought to impose sanctions on King, North, and their counsel for their "frivolous motion." While the motion for summary disposition was pending, King hired new counsel, who filed a motion seeking to withdraw the motion for summary disposition as to King.<sup>20</sup> While King's motion to withdraw was pending, the Hearing Officer denied the respondents' motion for summary disposition on December 8, 2014, finding that the respondents failed to demonstrate that there were no genuine issues of material fact.<sup>21</sup> Specifically, the Hearing Officer identified open issues as to the integrity of Southridge's electronic communications that Enforcement had obtained from Smarsh and produced to North and King.<sup>22</sup>

On February 6, 2015, North filed a Motion Respecting Expert Testimony and a later supplement, seeking permission to present the expert testimony of two different experts—JB and either TM or JG. North described them as "persons with expertise in electronic file

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<sup>20</sup> In her motion, King stated she "no longer wish[ed] to pursue the claims of spoliation advanced by [her previous counsel] on [her] behalf."

<sup>21</sup> The Hearing Officer later denied Enforcement's motion for sanctions at the hearing.

<sup>22</sup> North also filed an action in the United States District Court for the District of Columbia against FINRA and Smarsh making similar allegations to those raised in the motion for summary disposition and alleging that the data produced by Smarsh and relied upon by FINRA was spoliated and tampered. The district court dismissed the action on December 4, 2015. *See North v. Smarsh*, 160 F. Supp. 3d 63 (D.D.C. 2015).

transportation and preservation” and proffered that they “will offer factual and opinion testimony relevant to a determination about the nature and extent of spoliation of the electronically stored information (‘ESI’) relevant to the complaint and defenses in this matter.” In its opposition, Enforcement asserted that the spoliation claims were spurious but, more importantly, not relevant to the allegations against North because Enforcement’s intended proof of North’s violations did not include electronic correspondence.<sup>23</sup> Rather, Enforcement intended to rely on testimony, Southridge’s written supervisory procedures, and the Smarsh reports.

The Hearing Officer denied North’s Motion Respecting Expert Testimony in an order issued on March 5, 2015, and a supplemental order issued on March 12, 2015. The Hearing Officer “found that North failed to demonstrate that the expert testimony would be relevant or helpful to the Hearing Panel in resolving the issues in controversy relating to [North].” The Hearing Officer noted that the proposed testimony of the experts related to electronic correspondence and not the Smarsh reports that Enforcement intended to offer at the hearing.

On March 17, 2015, King settled the charges against her, and the hearing proceeded solely against North.

On April 13, 2015, the morning of the hearing, the Hearing Panel held an evidentiary hearing regarding the admissibility of the Smarsh reports offered by Enforcement. RS, a Smarsh senior manager of client data and manager of a team that handles data that is imported into and exported from Smarsh, testified telephonically about the reports, was cross-examined by North’s counsel, and was questioned by the panelists. The Hearing Officer thereafter admitted the Smarsh reports over North’s objections.

b. The Smarsh Reports Were Admissible and Reliable

North admitted that he did not review Bloomberg communications during the relevant period. The primary evidence against North regarding his review of Southridge emails is the Smarsh reports. The Hearing Officer ruled that the Smarsh reports were admissible, and the Hearing Panel found them reliable. On appeal, North challenges these findings. We find that these findings were proper and well supported by the record.

Under FINRA Rule 9263(a), a Hearing Officer must admit all relevant evidence and has discretion to exclude all evidence that is irrelevant, unduly repetitious, or unduly prejudicial. We review the admission or exclusion of evidence only for an abuse of discretion. *See Robert J. Prager*, 58 S.E.C. 634, 664 (2005). “Because this discretion is broad, the party arguing abuse of discretion assumes a heavy burden that can be overcome only upon showing that the Hearing Officer’s reasons to admit or exclude the evidence were so insubstantial as to render . . . [the admission or exclusion] an abuse of discretion.” *Dep’t of Enforcement v. Weinstock*, Complaint

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<sup>23</sup> Enforcement’s intended proof against King did rely on electronic correspondence and emails, but she had withdrawn her support of the spoliation claims and consented on December 9, 2014, to an order granting preclusion that she could not make such claims at the hearing.

No. 2010022601501, 2016 FINRA Discip. LEXIS 34, \*36-37 (FINRA NAC July 21, 2016). North did not meet his burden.

The Smarsh reports are three documents prepared by Smarsh that show: (1) the date of North's email searches; (2) the random percentage that he used to search emails; (3) the number of results obtained by the searches; (4) the number of emails archived for review; and (5) the maximum number of emails he reviewed. RS testified that Smarsh created the reports at Enforcement's request for information regarding North's searches of electronic communications. RS oversaw the preparation of the reports. The Smarsh reports were first provided to North by Enforcement on November 30, 2014, and Enforcement listed them on its proposed exhibit list filed on March 9, 2015.

North, relying on Federal Rules of Evidence 901, 902, 803(6), and 1006, argues that the Smarsh reports were inadmissible because they are summary reports without the underlying supporting data. According to North, the underlying data (i.e., the emails) were spoliated or could not be produced. We disagree that emails, or their integrity, affect the admissibility of the Smarsh reports in this instance. It is well settled that the formal rules of evidence do not apply in FINRA proceedings, but FINRA adjudicators may look to the Federal Rules of Evidence for guidance. *See, e.g., Dep't of Enforcement v. Ahmed*, Complaint No. 2012034211301, 2015 FINRA Discip. LEXIS 45, at \*112 (FINRA NAC Sept. 25, 2015) (citing FINRA Rule 9145(a)). But as a factual matter, the Smarsh reports were not summary exhibits. Rather, the Smarsh reports were printouts of data, compiled automatically at the time of North's review, and stored in Smarsh's database in the course of Smarsh's business. RS properly authenticated the reports at the evidentiary hearing and explained how they were created and using what data.

North asserts that it is "simple logic that if Smarsh did not capture and archive Email, it could not have recorded the 'count' of the Emails or recorded the compliance actions of any Southridge principal." We also reject this argument. At the evidentiary hearing, RS unequivocally testified that the Smarsh reports "[were] based off of the search and review history in the database," and the reports were not prepared using the information derived from emails. The Hearing Panel credited this testimony and explicitly found that the Smarsh reports were reliable based on the testimony of RS. To wit, the Hearing Panel stated, "[RS's] testimony, which was not undercut by cross examination, established that the reports were reliable and accurately reflected North's email reviews." We, like the Hearing Panel, found RS's testimony persuasive.

Unlike RS's testimony, the Hearing Panel found that North's testimony regarding his review of emails was "tentative, uncorroborated, and at times inconsistent," so the Hearing Panel "did not credit it regarding the frequency of his reviews" and instead relied on the Smarsh reports. We see no reason on appeal to disturb the Hearing Panel's findings, which also had the full benefit of an evidentiary hearing, at which RS testified, was cross examined, and was questioned by the panelists specifically about the reliability of the Smarsh reports. *See Daniel D. Manoff*, 55 S.E.C. 1155, 1162 n.6 (2002) ("Credibility determinations by a fact-finder deserve 'special weight.'"); *see also Dep't of Enforcement v. McGuire*, Complaint No. 2011027350301, 2015 FINRA Discip. LEXIS 53, at \*21-22 (FINRA NAC Dec. 17, 2015).

North also contends that, "[b]ecause Smarsh did not archive any Southridge employees' Email it is not possible to know what records were available to [North] . . . and whether any data

was searchable.” North’s argument misses the mark. Here, the point is not what specific emails were flagged for North’s review using the SMC. Rather, the point is how infrequently North conducted email searches on the SMC and how few emails he reviewed. And North is not being found liable for Smarsh’s alleged failure to archive electronic communications or his inability to turn up particular emails during his searches. Rather, he is being found liable for his failure to adequately review electronic communications based on the Smarsh reports, which show infrequent reviews of a small number of emails.

In sum, we agree with the Hearing Panel that North did not present persuasive evidence that the Smarsh reports were unreliable. Nor does he present cogent arguments on appeal to reject the Hearing Panel’s reasoned findings.<sup>24</sup>

c. North’s Experts Were Properly Excluded

The Hearing Officer excluded North’s experts, finding that their testimony was irrelevant to the allegations against North. The Hearing Officer did not abuse his discretion when excluding this evidence. *See Weinstock*, 2016 FINRA Discip. LEXIS 34, at \*36-37.

At the hearing, Enforcement relied on testimony, Southridge’s written supervisory procedures, and the Smarsh reports—not electronic communications—to prove North’s violative conduct. As the Hearing Panel stated, “[the proposed expert testimony] did not specifically address the Smarsh reports or find that they were unreliable based on problems with the integrity of the emails. Rather, the expert intended to opine on the purported alteration and manipulation of the headers and contents of certain emails. Accordingly, the Hearing Officer denied the request.”

On appeal, North argues that the “Hearing Officer erred about the relevance of email.” North continued that emails were relevant because they are the source material of the Smarsh reports, on which Enforcement and the Hearing Panel relied, and “[email] and its metadata are admissible to prove the failures of the archive and evidence.” North’s assertion that “all the source material (i.e., emails) related to the Smarsh Report was lost or unavailable” is directly at odds with RS’s credible testimony that Smarsh used *no* “actual email messages” to prepare the reports but instead used the “search and review history” database.<sup>25</sup> As we previously stated, we

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<sup>24</sup> In 2014, Smarsh upgraded its computer system and chose not to migrate Bloomberg data for former clients that had not been clients for a number of years, including Southridge. On appeal, North argues that Smarsh’s failure to migrate Southridge’s Bloomberg communications is problematic with respect to the allegations and evidence against North. North’s argument fails. Enforcement relied on North’s admission, not Smarsh reports, to prove that North never reviewed Bloomberg communications during the relevant period. Moreover, Smarsh’s failure to migrate Southridge’s Bloomberg communications does not affect the reliability or admissibility of the Smarsh reports, which concern North’s review of emails.

<sup>25</sup> It is also at odds with North’s own (and at times inconsistent) testimony that he ran searches on the SMC and reviewed at least some of the emails returned by those searches.

found RS's testimony persuasive, and it supports both the Hearing Panel's and our conclusion about the irrelevancy of emails and spoliation claims in this case. Based on RS's testimony that the Smarsh reports were derived from the "search and review history" database, whether the emails were "spoliated" would not affect the reliability of the Smarsh reports. Thus, North's proffered expert testimony about the "extent and condition of the Email data, likely causes of the failure of the archive, the alteration, spoliation and tampering to the files, and responsible party(ies)"—which does not address the reliability of the Smarsh reports and its real-time populated "search and review history" database from which they were created—was not relevant. And North has not offered any cognizable argument that "spoliated" emails could affect the data in the Smarsh reports about the frequency of North's email review or the extent and depth of North's searches, which are at issue in this matter.

North also argues that the Hearing Officer "capriciously flip-flopped" about the relevancy of emails. We disagree. The Hearing Officer previously found there were genuine issues of material fact related to the integrity of electronic communications when he denied North *and King's* motion for summary disposition. As an initial matter, we note the salient issues in this matter continued to be identified as it proceeded and were in turn briefed extensively by the parties. More importantly, North's argument ignores that the emails were relevant to King's violative conduct, but were not relevant to North's violative conduct.

Whether the emails were spoliated does not affect our decision that North failed to adequately review electronic correspondence at Southridge. North admits that he reviewed no Bloomberg communications during the relevant period, which in and of itself is sufficient to prove the misconduct. Moreover, the emails, and their corresponding metadata, do not negate or raise any question about the reliability of the Smarsh reports. North argues that Enforcement's failure to provide the "Email meta layers" was not harmless error. We disagree with the underlying premise, and find "Email meta layers" were not relevant to the allegations against North and thus it was not an error to exclude them or the proffered expert testimony about evidence spoliation.<sup>26</sup>

In sum, North's proffered expert testimony was irrelevant and properly excluded by the Hearing Officer.<sup>27</sup>

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<sup>26</sup> It likewise was not necessary for Enforcement to produce its own expert to refute North's claims about email spoliation.

<sup>27</sup> On appeal, North filed a motion to adduce additional evidence under FINRA Rule 9346 seeking to introduce additional evidence to support the same spoliation claims, including another expert. We denied this motion because the proposed evidence was immaterial for the same reasons provided herein.

D. North Did Not Prove that the Hearing Officer's Rulings Reflected Bias or Willful Ignorance

For the first time on appeal, North claims that the Hearing Officer was biased against him “due to his connection to prior proceedings involving [Cowle].”<sup>28</sup> North, however, waived any argument that he may have concerning the Hearing Officer's bias by failing to file a motion to disqualify the Hearing Officer when he was afforded an opportunity to do so. Pursuant to FINRA Rules 9233 and 9234, a party having a reasonable, good faith belief that bias exists, may file a motion to disqualify a Hearing Officer no later than 15 days after learning of the facts on which the claim is based. *See* FINRA Rules 9233(b) and 9234(b).

Although not clear, it appears that North contends that the Hearing Officer's bias became evident during the hearing based on his rulings. North, however, did not raise any concerns during the hearing and chose to proceed. His objection on appeal is therefore untimely, and he has waived his right to object to the Hearing Officer's participation in the proceedings below. *See* FINRA Rules 9233(b), 9234(b); *see also Weinstock*, 2016 FINRA Discip. LEXIS 34, at \*33 (failing to make timely motion to disqualify Hearing Officer and Hearing Panelist waives objection on appeal); *Dep't of Enforcement v. Bullock*, Complaint No. 2005003437102, 2011 FINRA Discip. LEXIS 14, at \*51 (FINRA NAC May 6, 2011) (failing to make timely motion to disqualify Hearing Officer waives objection on appeal).

Even if North's assertion of bias was timely, we find it wholly unsubstantiated by the record and thus “an insufficient basis to invalidate” the proceeding below. *See Dist. Bus. Conduct Comm. v. Guevara*, Complaint No. C9A970018, 1999 NASD Discip. LEXIS 1, at \*39 n.16 (NASD NAC Jan. 28, 1999), *aff'd*, 54 S.E.C. 655 (2000), *aff'd*, 47 F. App'x 198 (3d Cir. 2000). North appears to be basing his claims of bias on the Hearing Officer's adverse rulings, including the rejection of his proffered experts and his ruling about the relevancy of emails. Adverse rulings, however, alone do not evidence bias. *See Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at \*62 (Jan. 30, 2009), *aff'd*, 416 F. App'x 142 (3d Cir. 2010); *Weinstock*, 2016 FINRA Discip. LEXIS 34, at \*34. And the Hearing Officer's rulings are well supported by the record.

Regardless, the NAC's de novo review ensures that FINRA's disciplinary matters are fair and without bias.<sup>29</sup> *See Weinstock*, 2016 FINRA Discip. LEXIS 34, at \*35 (confirming that the NAC's de novo review cures any alleged Hearing Panel bias).

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<sup>28</sup> In North's pre-hearing brief, North asserted that the Hearing Officer “appeared to have been [in Enforcement counsel's] chain of command” while at FINRA. During the first day of the hearing, the Hearing Officer testified that, to his knowledge, he had never been in counsel's chain of command, and Enforcement's counsel testified to the same. North did not raise any objections at the time. This relationship, or lack thereof, does not appear to be the basis of North's bias claims on appeal.

<sup>29</sup> On appeal, North asserts that “[t]he Hearing Officer's irrelevance ruling [was] intended to protect Enforcement from exposure for tampering with evidence.” North also asserts,

#### IV. Sanctions

The Hearing Panel fined North a total of \$40,000, imposed a consecutive 30-business-day suspension and two-month suspension, both in any principal capacity, and censured him. After an independent review of the record, we modify these sanctions.

##### A. North's Failure to Report a Relationship with a Statutorily Disqualified Person

The Hearing Panel fined North \$10,000 and imposed a 30-business-day suspension in all principal capacities for his failure to report a relationship with a statutorily disqualified person. We affirm this sanction.

For the failure to report a relationship with a statutorily disqualified person, the FINRA Sanction Guidelines (“Guidelines”) recommend a fine of \$5,000 to \$146,000 and a suspension of the responsible principal in all supervisory capacities for 10 to 30 business days.<sup>30</sup> In egregious cases, the Guidelines recommend that adjudicators consider suspending the responsible principal in any or all capacities for up to two years or barring the responsible principal in all supervisory capacities.<sup>31</sup>

In addition to the principal considerations that apply when determining sanctions for all violations,<sup>32</sup> the Guidelines for failure to report a relationship with a statutorily disqualified person instruct the adjudicator to consider whether the unreported event would have established a pattern of potential misconduct.<sup>33</sup> We agree with the Hearing Panel that this factor is

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[cont'd]

“Enforcement’s resistance to and the Hearing Officer’s efforts to bar expert testimony suggests that Enforcement is actively hiding the truth.” We find nothing in the record to support these claims. We likewise find nothing in the record to support North’s assertion that Enforcement was “sidestep[ing]” or “waiv[ing] the archiving requirements” of 17 C.F.R. § 240.17a-4(f)(ii) or other provisions of the Exchange Act, that Enforcement engaged in “gaslighting” or “psychological abuse” of North at his on-the-record interview by using electronic communications as exhibits, that Enforcement “sabotaged” the only means—i.e., emails—by which North could have discovered King’s relationship with Cowle, or that Enforcement otherwise engaged in misconduct. Finally, we find North’s claims of collusion between Enforcement and Smarsh without merit.

<sup>30</sup> *FINRA Sanction Guidelines 73* (2016), [http://www.finra.org/sites/default/files/Sanctions\\_Guidelines.pdf](http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf) [hereinafter *Guidelines*].

<sup>31</sup> *Id.*

<sup>32</sup> *Id.* at 6-7.

<sup>33</sup> *Id.* at 73.

aggravating. Had North investigated the existing red flags concerning the KAM-UTA service agreement and invoices in March 2010, he would have discovered that Cowle, whom he previously was aware was statutorily disqualified, was connected to UTA. North's failure to investigate and, in turn, report the relationship enabled King to assist Cowle's subversion of Section 15 of the Exchange Act, unbeknownst to FINRA, for many months. We find North's failure to report King's relationship shortly after March 2010 was at least negligent.<sup>34</sup> North admits he learned about King's relationship in December 2010, but he did not report it because he insisted FINRA already knew about the relationship so he was not required to do so. North, however, still was required to follow the reporting requirement of NASD Rule 3070. Thus, as of December 2010, his failure to report was intentional, which we also find aggravating<sup>35</sup> and continued for another six months.<sup>36</sup> Finally, we find aggravating that North failed to accept responsibility for his misconduct, insisting that his conduct was not violative and FINRA was responsible.<sup>37</sup>

The information reported by members pursuant to NASD Rule 3070 "provides [FINRA] with important regulatory information that assists with the timely identification of problem members, branch offices, and registered representatives to detect and investigate potential sales practice violations." *NASD Notice to Members 96-85*, 1996 NASD LEXIS 107, at \*3 (Dec. 1996). Taking into consideration all the relevant facts, and in particular the possibility that the failure to disclose the relationship allowed King's pattern of misconduct with Cowle to continue,<sup>38</sup> we agree with the Hearing Panel that a sanction within the mid-range provided by the Guidelines is appropriate. Thus, we affirm the sanctions imposed by the Hearing Panel and fine North \$10,000 and impose a 30-business-day suspension in all principal and supervisory capacities.<sup>39</sup>

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<sup>34</sup> See *id.* at 6-7 (Principal Considerations in Determining Sanctions, Nos. 3, 13).

<sup>35</sup> See *id.* at 7 (Principal Considerations in Determining Sanctions, No. 13).

<sup>36</sup> See *id.* at 6 (Principal Considerations in Determining Sanctions, No. 9).

<sup>37</sup> See *id.* at 6 (Principal Considerations in Determining Sanctions, No. 2).

<sup>38</sup> See *Guidelines*, at 73.

<sup>39</sup> The Hearing Panel's 30-business-day suspension was in all principal capacities. We thus amend the Hearing Panel's order to include a 30-business-day suspension also in all supervisory capacities.

B. Failure to Establish a Reasonable Supervisory System for the Review of Electronic Correspondence

The Hearing Panel fined North \$10,000 and censured him for his failure to establish and maintain a reasonable supervisory system related to the review of electronic correspondence. We affirm the \$10,000 fine and reverse the censure.

For deficient written supervisory procedures, the Guidelines recommend a fine of \$1,000 to \$37,000.<sup>40</sup> In egregious cases, the Guidelines recommend suspending the responsible individual in any or all capacities for up to one year.<sup>41</sup> In evaluating the appropriate sanctions to impose, the Guidelines offer two principal considerations, one of which is relevant here: whether deficiencies allowed violative conduct to occur or to escape detection.<sup>42</sup> We also consider the principal considerations from the Guidelines.<sup>43</sup>

North was responsible for establishing and maintaining a reasonable supervisory system at Southridge for the review of electronic correspondence. Southridge's 2008 and 2010 written supervisory procedures, however, were inadequate and unreasonable under the circumstances. We find that North's supervisory failures were serious, though not egregious. In reaching this conclusion, we considered that the deficient procedures allowed violative conduct to continue because they contributed to North's inadequate review of electronic correspondence.<sup>44</sup> We find this aggravating. Had the procedures not been deficient, North's review of correspondence may not have been so haphazard because specific guidelines and review procedures would have dictated his review.

It is also aggravating that the deficiencies in the written supervisory procedures persisted over a two-year period and included two sets of written supervisory procedures.<sup>45</sup> Although North may not have prepared the 2008 procedures, he was responsible for maintaining them, and he established and maintained the 2010 procedures. We note that Southridge's procedures, for the most part, seemingly were tailored to its business. Nonetheless, the quality of the procedures with respect to the review of electronic correspondence was lacking. These specific procedures failed to take into account the particulars of Southridge, including the size of the firm, the nature of its business, and the fact that many registered representatives used Bloomberg

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<sup>40</sup> *Id.* at 103.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.* at 6-7.

<sup>44</sup> *Id.* at 103.

<sup>45</sup> *See id.* at 6 (Principal Considerations in Determining Sanctions, No. 9).

communications to communicate. *See FINRA Regulatory Notice 07-59*, 2007 FINRA LEXIS 58, at \*32 (Dec. 2007). In particular, the 2010 procedures were problematic because they contained incomplete procedures and an unmodified template. All of these deficiencies aggravate the misconduct.

Quite simply, Southridge did not have reasonable supervisory procedures in place during the relevant period with respect to the review of electronic correspondence, and North was responsible for Southridge's shortcomings in this area. After taking into consideration all of the relevant facts, we agree that a fine in the lower range of the Guidelines is appropriate for North's negligent misconduct. We therefore affirm the \$10,000 fine imposed by the Hearing Panel. We eliminate the censure imposed by the Hearing Panel because FINRA generally does not censure associated persons when a suspension is imposed. *See NASD Notice to Members 99-91*, 1999 NASD LEXIS 121, at \*6-7 (Nov. 1999); *see also Guidelines*, at 9.

C. Failure to Supervise Electronic Communications

The Hearing Panel fined North \$20,000 and imposed a two-month suspension in all principal capacities for his failure to adequately review electronic correspondence. We affirm this sanction.

For a failure to supervise, the Guidelines recommend a fine of \$5,000 to \$73,000.<sup>46</sup> In evaluating the appropriate sanctions to impose, the Guidelines provide three principal considerations: (1) whether respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny; (2) the nature, extent, size and character of the underlying misconduct; and (3) the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls.<sup>47</sup> The Guidelines also instruct the adjudicator to consider suspending the responsible individual in all principal capacities for up to 30 business days.<sup>48</sup> In egregious cases, the Guidelines advise adjudicators to consider imposing a longer suspension in all capacities or barring the responsible individual.<sup>49</sup>

"Assuring proper supervision is a critical component of broker-dealer operations." *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at \*27 (June 29, 2007). FINRA relies on its member firms to maintain robust supervisory systems to ensure compliance with FINRA Rules and securities laws and to protect the investing public. *See id.* Southridge's supervision of electronic correspondence was unreasonable, and North is responsible for these shortcomings.

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<sup>46</sup> *Guidelines*, at 102.

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

There are several aggravating factors. First, North ignored “red flags”—the KAM-UTA service agreement and invoices—that should have resulted in additional supervisory scrutiny.<sup>50</sup> At the very least, he should have conducted more targeted searches, including key word searches, on King’s email to investigate the relationship. North also admits that he never reviewed Bloomberg communications during the relevant period because he was unaware he had to run separate searches. We find the fact that none of his searches on the Smarsh SMC produced Bloomberg communications also should have been a red flag to him that his electronic communication review was inadequate.

North knew that he was responsible for the review of electronic correspondence at Southridge, so he alone was in the best position to understand how his implementation of the review of the firm’s electronic correspondence was lacking.<sup>51</sup> He admittedly never reviewed any Bloomberg communications during the relevant period. There also were multiple periods (including three, four, and five months) in which he reviewed no emails. Other times, although he reviewed emails, his reviews were insufficient and inadequate considering the size of Southridge, the number of registered representatives, and the total amount of emails exchanged during the relevant period.<sup>52</sup> The fact that North’s misconduct persisted over an extended period also is aggravating.<sup>53</sup> We note that the 2008 and 2010 written supervisory procedures were insufficient, but North compounded the problems with his inadequate email review and the fact he reviewed no Bloomberg communications during the entire relevant period.<sup>54</sup>

We agree with the Hearing Panel that North’s misconduct was egregious and reckless and warrants significant sanctions.<sup>55</sup> There are no mitigating circumstances. We therefore affirm the sanctions imposed by the Hearing Panel and fine North \$20,000 and impose a two-month suspension in all principal and supervisory capacities.<sup>56</sup> The suspensions for North’s supervisory failures are to run consecutively.

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<sup>50</sup> See *Guidelines*, at 102.

<sup>51</sup> See *id.*

<sup>52</sup> See *id.*

<sup>53</sup> See *id.* at 6 (Principal Considerations in Determining Sanctions, No. 9).

<sup>54</sup> See *id.* at 6 (Principal Considerations in Determining Sanctions, No. 5).

<sup>55</sup> See *id.* at 102; *id.* at 7 (Principal Considerations in Determining Sanctions, No. 13).

<sup>56</sup> The Hearing Panel’s two-month suspension was in all principal capacities only. We thus amend the Hearing Panel’s order to include a two-month suspension also in all supervisory capacities.

V. Conclusion

North failed to report a relationship with a statutorily disqualified person, willfully failed to establish and maintain a reasonable supervisory system for the review of electronic correspondence, and willfully failed to adequately review electronic correspondence. For his collective misconduct, we fine North \$40,000, impose a 30-business-day suspension in all principal and supervisory capacities followed by a two-month suspension in all principal and supervisory capacities. We also order that North pay hearing costs of \$4,404.51 plus appeal costs of \$1,536.89. As the result of his willful violations of MSRB rules, North is statutorily disqualified.<sup>57</sup>

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith  
Executive Vice President and Corporate Secretary

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<sup>57</sup> Pursuant to FINRA Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.